

# THE FAIR CREDIT CARD ACT OF 1986

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HEARING  
BEFORE THE  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
AND CONSUMER AFFAIRS  
OF THE  
COMMITTEE ON  
BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE  
NINETY-NINTH CONGRESS

SECOND SESSION

ON

**S. 2140**

TO AMEND THE TRUTH IN LENDING ACT TO REQUIRE CERTAIN  
DISCLOSURES AT THE TIME OF THE INITIAL APPLICATION

**S. 2264**

TO AMEND THE TRUTH IN LENDING ACT

**S. 2421**

TO AMEND THE TRUTH IN LENDING ACT

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MAY 21, 1986

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Printed for the use of the Committee on Banking, Housing, and Urban Affairs



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# CONTENTS

WEDNESDAY, MAY 21, 1986

|                                              |           |
|----------------------------------------------|-----------|
| Opening statement of Senator Gorton .....    | Page<br>1 |
| Opening statements of:                       |           |
| Senator Hecht .....                          | 12        |
| Senator D'Amato .....                        | 12        |
| Prepared statement .....                     | 14        |
| Nilson report .....                          | 24        |
| Senator Dodd .....                           | 52        |
| Senate bills S. 2140, S. 2264, S. 2421 ..... | 3         |

## WITNESSES

|                                                                                                                                                                         |     |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| Emmett J. Rice, Governor, Federal Reserve Board; accompanied by Griffith L. Garwood, Director, Division of Consumer and Community Affairs, Federal Reserve System ..... | 15  |
| Disclosure requirements of the three bills .....                                                                                                                        | 15  |
| Computation methods .....                                                                                                                                               | 16  |
| Study on comparative cost .....                                                                                                                                         | 17  |
| Prepared statement .....                                                                                                                                                | 18  |
| Response to written questions of:                                                                                                                                       |     |
| Senator Gorton .....                                                                                                                                                    | 25  |
| Senator D'Amato .....                                                                                                                                                   | 28  |
| Witness discussion:                                                                                                                                                     |     |
| Burden of disclosure .....                                                                                                                                              | 34  |
| Fed favors disclosure .....                                                                                                                                             | 34  |
| Reports from the Fed twice a year .....                                                                                                                                 | 36  |
| Consumers being overcharged .....                                                                                                                                       | 37  |
| Alan Fox, legislative representative, Consumer Federation of America .....                                                                                              | 38  |
| Four key elements to pricing .....                                                                                                                                      | 39  |
| Standardize balance calculation methods .....                                                                                                                           | 40  |
| Prepared statement .....                                                                                                                                                | 41  |
| Appendix: Significant differences between the bills .....                                                                                                               | 43  |
| Response to written questions of Senator Gorton .....                                                                                                                   | 136 |
| Elgie Holstein, associate director, Bankcard Holders of America .....                                                                                                   | 44  |
| Interest rate of 19.4 percent for 25 largest issuers .....                                                                                                              | 44  |
| Grace period is a confusing item .....                                                                                                                                  | 45  |
| Fed data .....                                                                                                                                                          | 47  |
| Prepared statement .....                                                                                                                                                | 49  |
| Panel discussion:                                                                                                                                                       |     |
| Preemption of State disclosure laws .....                                                                                                                               | 51  |
| Disclosure at time of receipt of card .....                                                                                                                             | 53  |
| Jerry D. Craft, senior vice president, First National Bank of Atlanta and chairman of the retail electronic services and bank card division, ABA .....                  | 55  |
| Prepared statement .....                                                                                                                                                | 55  |
| Response to written questions of Senator Gorton .....                                                                                                                   | 140 |
| Ralph Rohner, professor, Catholic University, representing Consumer Bankers Association .....                                                                           | 62  |
| CBA opposes present bills .....                                                                                                                                         | 62  |
| Disclosure should be narrowly focused .....                                                                                                                             | 62  |
| Prepared statement .....                                                                                                                                                | 64  |
| I. New disclosure legislation is inconsistent with recent congressional simplification efforts and complicated by State requirements .....                              | 65  |

# IV

|                                                                                                        |      |
|--------------------------------------------------------------------------------------------------------|------|
| Ralph Rohner, professor, Catholic University, representing Consumer Bankers Association—Continued      |      |
| Prepared statement—Continued                                                                           | Page |
| II. The various disclosure proposals raise common issues .....                                         | 68   |
| III. Any required disclosure terms should be limited to the annual percentage rate and annual fee..... | 74   |
| IV. Federal preemption of State disclosure provisions is essential.....                                | 77   |
| V. Congress should not mandate a uniform balance computation method.....                               | 78   |
| VI. Transitional periods .....                                                                         | 84   |
| Attachment A—Current credit card disclosures required by Truth in Lending Act/regulation Z.....        | 85   |
| Response to written questions of:                                                                      |      |
| Senator Gorton.....                                                                                    | 143  |
| Senator D'Amato .....                                                                                  | 153  |
| Meredith Fernstrom, senior vice president, office of public responsibility, American Express Co.....   | 86   |
| Features of charge cards.....                                                                          | 86   |
| Prepared statement .....                                                                               | 88   |
| Proposed amendments to S. 2421, S. 2264, and S. 2140.....                                              | 90   |
| Sheldon Feldman, attorney, representing the National Retail Merchants Association.....                 | 92   |
| Limit disclosure to three key items.....                                                               | 92   |
| State statutes are adequate.....                                                                       | 92   |
| Prepared statement .....                                                                               | 94   |
| The proposed legislation.....                                                                          | 94   |
| Credit card solicitation disclosures.....                                                              | 95   |
| Balance method regulation.....                                                                         | 96   |
| Appendix: State statutory provisions—open-end credit—balance method computation.....                   | 98   |
| Response to written questions of Senator Gorton.....                                                   | 173  |
| Panel discussion: Refinement needed in the bills .....                                                 | 135  |

## ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

|                                                                              |     |
|------------------------------------------------------------------------------|-----|
| American Retail Federation, Joseph P. O'Neil, president .....                | 174 |
| Bank Credit Card Observer, John Crothers Pollock, editor in chief.....       | 185 |
| Engineering News-Record, David E. Wojick, engineer .....                     | 193 |
| Federal Reserve System, staff .....                                          | 213 |
| First Data Resources Inc., Edward C. Nafus .....                             | 282 |
| Journal of Retail Banking, Robert O. Metzger, Ph.D. and Sukhen Dey, Ph.D.... | 285 |
| Sears, Roebuck & Co., Randolph H. Aires, vice president.....                 | 304 |

# THE FAIR CREDIT CARD ACT OF 1986

WEDNESDAY, MAY 21, 1986

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS, SUBCOMMITTEE ON FINANCIAL INSTITU-  
TIONS AND CONSUMER AFFAIRS,

*Washington, DC.*

The subcommittee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Slade Gorton (chairman of the subcommittee) presiding.

Present: Senators Gorton, Garn, Hecht, D'Amato, Armstrong, Proxmire, Cranston, and Dodd.

## OPENING STATEMENT OF SENATOR GORTON

Senator GORTON. This morning the subcommittee will hold a hearing on three bills pertaining to credit cards. These bills grew out of an earlier hearing held by this subcommittee in January which focused on proposals for a Federal credit card usury ceiling. The bills under consideration today do not include such a proposal but do address themselves to problems identified at that earlier hearing.

The three bills, S. 2140, introduced by Senator Dodd; S. 2264, by Senator D'Amato; and S. 2421, which is my own; all address the issue of disclosure of terms on credit card solicitations. My own bill also includes a provision regulating the method used by issuers to calculate the unpaid balance against which interest charges are assessed.

With respect to the disclosure proposals, it is my intention to search for a simple disclosure to get the relevant information in front of the consumer in a way in which it will be used.

Disclosed information is of no value if it is so complicated or lengthy that it is not used.

While I recognize that disclosure which is not exhaustive leaves open the possibility that some element of cost will be unrecognized, I believe that it is appropriate at the solicitation stage that disclosures be somewhat more abbreviated than those required at the contract stage.

Indeed, I believe that such a course is in the best interest of consumers.

I recognize that the requirement in S. 2421 that the Federal Reserve Board require certain balance calculation methods will be especially controversial. This bill would require that bank card issuers use either the average daily balance method or a method more favorable to consumers.

This raises two problems. First, because the method most favorable to a given consumer can depend on that consumer's charging and paying pattern, one method might be more favorable for some consumers and less favorable for others.

Second, to the degree that any variation is still permitted in balance calculation methods, the annual percentage rate will not be a completely faithful guide to costs.

I recognize both of these problems and I am interested in suggestions for dealing with them, but I do not find either argument a compelling reason for abandoning the proposal which would still represent an improvement over the current state of affairs.

I am particularly interested in prohibiting balance calculation methods which can cause the real cost of funds to consumers to exceed the stated annual percentage rate [APR]. The previous balance method is one example.

I am attracted to the average daily balance method for two reasons. First, if the credit issuer uses a pure average daily balance method with no free period, then the cost of funds to the consumer is exactly equal to the stated annual percentage rate. This seems to me to be a benchmark of fairness standard.

A corollary is that under such a balance calculation method cross-subsidies among classes of consumers are eliminated. If an extender of credit also includes a free period of any type, the real cost of funds to the consumer will be less than stated in the APR. How much lower it will be depends on a number of things, principally upon whether the issuer grants free periods on subsequent purchases in the presence of the carryover balance. If such an additional free period is granted the so-called current charges excluded method, then the true cost of funds can be substantially less than the APR. If such an additional free period is not granted, the so-called current charges included method, then the true cost of funds will still be less than the APR, though by a smaller degree.

But in neither case will the true cost exceed or even equal the stated APR and in neither case is there any element of retroactivity; that is, of applying a finance charge to a purchase which had previously enjoyed a free period.

As a result, I have difficulty understanding criticisms of the average daily balance method per se, although I certainly can understand criticisms of any method which does use a reachback or retroactive type mechanism in combination with the average daily balance method.

[Copies of proposed bills follow:]

99TH CONGRESS  
2D SESSION

## S. 2140

To amend the Truth in Lending Act to require certain disclosures at the time of the initial application.

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### IN THE SENATE OF THE UNITED STATES

MARCH 5 (legislative day, FEBRUARY 24), 1986

Mr. DODD introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

## A BILL

To amend the Truth in Lending Act to require certain disclosures at the time of the initial application.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*  
3       That section 127 of the Truth in Lending Act (15 U.S.C.  
4       1637) is amended by adding at the end thereof the following:

5       “(c) A card issuer shall clearly and conspicuously dis-  
6       close either on initial applications for a credit card or on ma-  
7       terials accompanying those applications—

8       “(1) the annual percentage rate applicable to ex-  
9       tensions of credit by means of that credit card or, in

1 the case of an extension of credit subject to a variable  
2 rate, the means for determining that rate;

3 “(2) any annual or other fee imposed for the issu-  
4 ance or use of that credit card;

5 “(3) the date by which or the period (if any)  
6 within which payment must be made to avoid addition-  
7 al finance charges, except that the creditor may, at his  
8 election and without disclosure, impose no such addi-  
9 tional finance charge if payment is received after such  
10 date or the termination of such period; and

11 “(4) a statement of how the balance on which the  
12 finance charge is computed is determined.

13 The Board shall monitor disclosures under this subsection to  
14 assure that they are clear, conspicuous, and accurate.”.

○



99TH CONGRESS  
2D SESSION

# S. 2264

To amend the Truth in Lending Act.

---

## IN THE SENATE OF THE UNITED STATES

MARCH 27 (legislative day, MARCH 18), 1986

Mr. D'AMATO introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

## A BILL

To amend the Truth in Lending Act.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Credit Card Disclosure  
5 Act of 1986".

6 **SEC. 2. DISCLOSURE IN CREDIT CARD APPLICATIONS.**

7 Section 127 of the Truth in Lending Act (15 U.S.C.  
8 1637) is amended by adding at the end thereof the following:

9 "(c) In any application to open any credit card account,  
10 or in any solicitation which offers to open such an account  
11 without the need for an application to be completed, a card  
12 issuer shall disclose—

1           “(1) the annual percentage rate used to determine  
2           a finance charge on any balances;

3           “(2) the time period (if any) within which any  
4           credit extended by means of that credit card may be  
5           repaid without incurring a finance charge, or if no such  
6           time period is provided, the creditor shall disclose such  
7           fact;

8           “(3) any minimum or fixed amount imposed as a  
9           monthly or other periodic finance charge; and

10          “(4) any annual or other charge or fee required to  
11          be paid for the use of the credit card account.”.

12   SEC. 3. REPORTING TO THE BOARD OF GOVERNORS.

13          Section 136 of the Truth in Lending Act (15 U.S.C.  
14   1646) is amended—

15               (1) by redesignating subsection (b) as subsection  
16               (c);

17               (2) by inserting after subsection (a) the following  
18               new subsection:

19               “(b) The issuer of any credit card shall submit quarterly  
20               to the Board the information required to be disclosed by sec-  
21               tion 127(c). The Board shall make such information available  
22               to the public upon request, and shall report such information  
23               annually to Congress.”; and



1 (3) by striking out "subsection (a)" in subsection  
2 (c), as redesignated, and inserting in lieu thereof "sub-  
3 sections (a) and (b)".

4 SECTION-BY-SECTION ANALYSIS

5 Currently, section 127 of the Truth in Lending Act (15  
6 U.S.C. § 1637) requires disclosure of certain information re-  
7 garding an open-end consumer credit plan before opening an  
8 account. This has been interpreted by the Federal Reserve  
9 Board in 12 C.F.R. § 226.5(b)(1) as requiring disclosure  
10 "before the first transaction is made under the plan." Thus,  
11 disclosure is not required in the application. Section 2 of this  
12 bill requires additional disclosure in an application for a credit  
13 card, as it is at the application stage that most consumers  
14 make the decision to obtain a credit card. However, less in-  
15 formation is required in the application than must currently  
16 be disclosed before the first transaction, since the goal of such  
17 disclosure is to permit easy comparisons between credit card  
18 plans.

19 The information to be disclosed pursuant to this amend-  
20 ment must meet the requirements to section 136 of the Truth  
21 in Lending Act (15 U.S.C. § 1646), which requires informa-  
22 tion to be disclosed "clearly and conspicuously, in accordance  
23 with regulations of the Board." Moreover, that section also  
24 requires the terms "annual percentage rate" and "finance  
25 charge" to be more conspicuous than other information  
26 except that relating to the identity of the creditor.

1 Under section 136 of the Truth in Lending Act (15  
2 U.S.C. § 1646), the Board is authorized to collect, publish,  
3 and provide limited dissemination to the public of annual per-  
4 centage rates charged for nonsale credit by creditors, and it  
5 may require such creditors to submit the information to the  
6 Board. Section 3 amends this provision by adding a require-  
7 ment that credit card issuers submit the annual percentage  
8 rate, along with grace periods, minimum finance charges, and  
9 annual fees, to the Board, which will make such information  
10 available to the public upon request and in an annual report  
11 to Congress. This will provide a means for better disclosure  
12 of information regarding credit cards, contributing to the effi-  
13 cient working of the market.

○

99TH CONGRESS  
2D SESSION

# S. 2421

To amend the Truth in Lending Act.

---

## IN THE SENATE OF THE UNITED STATES

MAY 7 (legislative day, MAY 5), 1986

Mr. GORTON introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

## A BILL

To amend the Truth in Lending Act.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       SECTION 1. This Act may be referred to as the "Fair  
4       Credit Card Act of 1986".

5       SEC. 2. Section 127 of the Truth in Lending Act is  
6       amended by adding at the end thereof the following:

7       “(c) The Board shall issue regulations that require  
8       credit card solicitations or advertisements mailed to the con-  
9       sumer to disclose clearly and conspicuously—

10       “(1) the annual percentage rate applicable to ex-  
11       tensions of credit obtained by use of the credit card;

1           “(2) the conditions under which a finance charge  
2       may be imposed, including the time period (if any)  
3       within which any credit extended may be repaid with-  
4       out incurring a finance charge, or, if no such time  
5       period is provided, the creditor shall disclose such fact;  
6       and

7           “(3) the annual fees and other charges, if any, ap-  
8       plicable to the issuance or use of the credit card.

9           “(d)(1) For any open end credit plan involving a credit  
10      card under which credit may be extended by a party other  
11      than the provider of goods or services, the balance upon  
12      which finance charges may be imposed shall be computed  
13      using an average daily balance method or any alternative  
14      method which results in lower finance charges than the aver-  
15      age daily balance method.

16          “(2) The Board shall by regulation prescribe criteria  
17      under which a balance calculation method may be deemed to  
18      be an average daily balance method or an alternative method  
19      which results in a lower finance charge for the purpose of  
20      paragraph (1). Such regulations shall—

21           “(A) permit issuers of credit cards to adopt grace  
22      periods during which credit is extended without incur-  
23      ring a finance charge, but shall not require the adop-  
24      tion of such a grace period; and

1           “(B) permit issuers of credit cards with cash ad-  
2           vance features to adopt different grace periods for cash  
3           advances than for credit advances, if any such different  
4           period is clearly disclosed.”.

○

Senator GORTON. I must tell the witnesses that a Banking Committee markup of the housing bill has been scheduled for 11 o'clock this morning. We will, therefore, have to move fairly quickly through the testimony. I intend to limit my oral questioning to give my colleagues additional time, but I do anticipate having written questions for all of the witnesses.

Senator Proxmire.

Senator PROXMIRE. I have no opening statement.

Senator GORTON. Senator D'Amato.

Senator D'AMATO. I think Senator Hecht has a brief statement.

Senator GORTON. Fine. Senator Hecht.

#### OPENING STATEMENT OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman. I'm sorry I have some other hearings that I have to be at this morning. I was at the last hearing dealing with credit cards and I want to point out one major point.

I am very concerned about Government or this committee ever legislating management. It appears that there is competition at the moment on interest rates pertaining to credit cards. In my opinion, the market is working right now and competition usually brings the best prices to the consumer. So I understand what you're trying to bring out today and go over all of this and I commend you for it, but we always have to watch out that we don't start legislating management.

Senator GORTON. Thank you, Senator.

Senator D'Amato.

#### OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman.

First of all, let me commend you for holding this hearing. I'm going to ask that the full text of my opening statement be placed in the record as if read in its entirety.

Senator GORTON. Without objection, it will be.

Senator D'AMATO. Let me attempt to summarize. Maybe in my summary I'll go longer than the prepared remarks.

Mr. Chairman, I've heard a lot about the free marketplace, competition. That just hasn't existed. There's been an absolute cabal among the largest 10 issuers with 1 or 2 exceptions, notably Manufacturers Hanover which dropped its rate 2 percent, but the others are all 19 percent and above.

In previous testimony before this committee regarding high interest rates we heard—"Oh, that doesn't account for too much, only 36 to 50 percent of the cost of the credit cards are interest sensitive," and yet while the interest that the banks have got to pay for borrowing money has come down in some cases 150 percent where they were paying as much as 16 percent in 1981, down to 6.5 to 7 percent, we have not seen any of those savings passed on to the consumers and, indeed, what the three bills attempt to do today—S. 2264, S. 2140, S. 2421—all in their respective ways, introduced by you, Mr. Chairman, Senator Dodd and myself, seek to get information out to the public so informed choices can be made.



And I have to say I can't understand the Federal Reserve position, Governor Rice's position. My God, you're absolutely against giving the marketplace the opportunity to work—"Don't let the consumers have that information because somehow if they get it then maybe they will begin to comparison shop." When I received this information, that's what I did. I did it because I learned from a colleague that you could get a MasterCard or a VISA card at an out-of-State bank, one that would be respected wherever you went. I didn't know that. I figured they've got their own little card and if you tried to shop in New York or Washington they'd say, "No," and I pay 12.5 percent as opposed to the 19.6.

I note that two larger banks have dropped their rates tremendously, for example 14.9 percent, DIME savings bank. I think the Drydock also came down. Testimony stating that the administration costs of this credit cards are so high is countered by the Nilson Report which shows that in terms of the operation of the banks that the greatest profit margin which is about 5.3 percent return, comes in the credit card area. No wonder why, the 10 largest dominate the market. They all peg their rates at about 19 percent plus. Where can people shop?

And then we've got the Federal Reserve testifying that "We can't even endorse disclosure. We're not in favor—you don't need disclosure." Now it's one thing for the Fed to oppose a floating cap, however I find it hard to justify a position that does not even endorse disclosures to get interest rate information out to the public. I think it's a rather sad commentary because what you're doing is limiting the ability of the free market system to operate. If consumers are unaware of price competition, that there are rates available that they can get the same services and indeed save 6 and 7 percent, then the competitive forces of the market cannot work.

So, Mr. Chairman, I think at the very least, we should enact legislation containing truth-in-lending and disclosure provisions such as those contained in S. 2264. I do not have pride in authorship, however it is imperative that the committee enact legislation that makes this information available to the public so we can drive those rates down.

When Mr. Rice testifies—and I read your testimony very carefully—he wonders about whether consumers really care about receiving this information. Be assured, Mr. Rice, that they do. The fact of the matter is our office received 100,000 inquiries as to where they could get this card or a card like it at banks that offer lower interest rates.

I would suggest that we have an obligation of making that information available to end the practice of legal usury inflicted on the consumer. You don't need usury laws unless people are pursuing usurious policies, and that's exactly what's taking place. Many card issuers are making a profit five times greater than their average in this one area. Therefore, I think we have an obligation to enact legislation that attempts to permit the free market system to really work.

Thank you, Mr. Chairman.

[The complete prepared statement follows:]



## STATEMENT OF SENATOR ALFONSE M. D'AMATO

This morning we are examining three bills, S. 2264 the Credit Card Disclosure Act of 1986 which I introduced, S. 2140 introduced by Senator Dodd and S. 2421 introduced by Senator Gorton. With the exception of a few minor differences, the purpose of the bills are the same. They are all designed to promote competition in the marketplace for credit cards by requiring disclosure of material information to credit card holders. The information that each bill requires credit card issuers to disclose on credit card solicitations and applications will provide consumers with useful information that they can use to comparison shop.

One of the most important features of any disclosure legislation is that information regarding differences in the cost of credit cards is widely disseminated. S. 2264 contains such a provision. I know that some critics of the bill will argue that consumers aren't interested in this information. However, if consumers become aware that some credit cards offer lower and more beneficial rates than others, then I guaranty that they will become interested in information that allows them to comparison shop.

After a review of some of this morning's testimony I must admit my amazement to see that some of the witnesses oppose the disclosure provisions that are before the subcommittee. Such a position is irresponsible and represents a contempt for consumers. During our last hearing the critics of an interest rate ceiling vehemently opposed a provision in S. 1922, the Credit Cardholder Protection Act, that established a 4 percent cap based on the prime rate. They complained that a floating ceiling would interfere with the free market. Their lamentations still ring in my ears: "Senator D'Amato let the free market work; there is plenty of competition in the marketplace but administrative costs are such that we need to charge 19 or 20 percent to make any profit on our credit card operations."

In response to the anguished pleading of the free marketers, I proposed that the free market could function best if consumers had adequate and comparative information regarding credit card interest rates, charges and fees. The free market can work only if consumers can shop for the best rates and thereby create true price competition in the marketplace. The restoration of price competition will reveal the hoax that many card issuers have perpetrated on the American consumer because interest rates will begin to come down. The hoax about the administrative costs eating up earnings on credit cards already has been partially revealed by the Nilson Report and I ask that a copy of a chart contained in that report be included in the record. The chart contains a breakdown of the costs to a bank's credit card operation and reveals that the profits generated from these operations are five times greater than the profits generated from other banking activities. Moreover, the Hoax is being revealed because institutions such as the Dime Savings Bank and Manufacturer's Hanover have lowered their rates and eroded the market share of the 10 largest bank card issuers. How can these banks and institutions charging even lower rates continue to make money—are the administrative costs really that much higher at the big banks charging 19.6 percent? I doubt it because economies of scale dictate that the bigger the bank's credit card operation the lower the administrative cost.

To those who claim that consumers aren't interested in learning of lower rates, I cite the interest generated among my constituents from the last hearing. My office has received 100,000 written inquiries in addition to hundreds of phone calls concerning the availability of low-cost credit cards. Consumers are interested in this information. Very few people would pay more for the same goods and services if they could be purchased elsewhere at the same expense. I am sure that credit cardholders possess the basic instinct of all consumers: They would be bargain hunters if only they knew where to find the bargain.

I am frankly dismayed by those who oppose the concept of additional disclosure because they reveal their disdain for their customers and consumers in general. They care nothing about the free market when the free market would result in a lowering of their profit margins. Their opposition to legislation that would restore competition to this market by lifting the conspiracy of silence which presently exists demonstrates their desire to continue gouging consumers while attempting to justify their actions by espousing free market rationales. I can not sit idly and witness the continued gouging of the American public.

I look forward to working with my colleagues to draft legislation that will enable credit card holders to shop for rates in a truly competitive market.

Senator GORTON. Mr. Chairman Garn.

Senator GARN. Mr. Chairman, I have no statement. I just thank you for holding these hearings.

Senator GORTON. Senator Cranston.

Senator CRANSTON. I join with Senator Garn.

Senator GORTON. Thank you.

Governor Rice, we are pleased to have you back in front of the committee again and we would be happy to hear your testimony.

**STATEMENT OF EMMETT J. RICE, GOVERNOR, FEDERAL RESERVE BOARD, ACCOMPANIED BY GRIFFITH L. GARWOOD, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, FEDERAL RESERVE SYSTEM**

Mr. RICE. Thank you, Mr. Chairman. Mr. Chairman, with your permission, I have with me this morning, Mr. Griffith Garwood, the Director of the Division of Consumer and Community Affairs.

Senator GORTON. We're happy to have him with you. I hope both of you will move those microphones a little closer to where you're speaking so everyone in the audience can hear you.

Mr. RICE. Mr. Garwood knows a great deal more about the subject we're going to be discussing this morning than I do and I'd like your permission to lean on him whenever I need to.

Senator GORTON. We'll be happy to hear from him whenever you wish.

Mr. RICE. Thank you. I have a shortened version of the statement that I submitted.

Senator GORTON. Fine. Your full written statement will be included in the record as if read in full.

Mr. RICE. And I may proceed with the shortened version?

Senator GORTON. You may.

Mr. RICE. Thank you, Mr. Chairman.

**DISCLOSURE REQUIREMENTS OF THE THREE BILLS**

I appreciate the opportunity to appear before this committee to discuss the disclosure requirements dealing with credit card applications and solicitations: S. 2140, S. 2264, and S. 2421. All three bills would add an early disclosure requirement to the Truth in Lending Act for open end credit card plans. S. 2421 is narrower than the other bills in that it deals only with disclosures in mail solicitations, though it also addresses the balance computation methods used by certain credit card issuers. S. 2264 would also require credit card issuers to report certain cost terms to the Board, and would require the Board in turn to make this information available to the public and to report it annually to the Congress.

Currently, the law requires early disclosures only when creditors engage in advertising. Solicitations for credit are thus subject to some truth in lending disclosure requirements, since they are considered advertisements under the statute and the Board's implementing regulation, regulation Z. Whenever certain credit terms are stated in an advertisement, the creditor must give additional information about the credit plan.

If none of the specified credit terms is stated in the solicitation, however, the law does not require that cost information about the plan be given. Under the current law, consumers must be given

full disclosure of the terms and conditions of the credit card program no later than the time they receive the card. Therefore, consumers do have an opportunity to review all of the terms and conditions before using the account.

The proposed bills go beyond the present act by requiring the creditor to include certain disclosures in any application or solicitation for a credit card plan, without regard to whether the creditor mentions a particular term.

The issue of how much disclosure to require in advertisements has been considered by the Congress, most recently in 1980 when it simplified the Truth in Lending Act. At that time, the Congress cut back on the disclosures required in open end credit advertisements in the hope that reducing the disclosure burden would promote more advertising, thereby increasing competition. Requiring disclosure in all applications whether or not the application is part of a mail solicitation might have the adverse effect which the Congress sought to avoid in 1980.

We are inclined to think that given the limited scope of the increased disclosure in S. 2421 it would not have that effect. Our impression is that many card issuers are already including in their mail solicitations much of the disclosure information proposed in the bill and presumably have not viewed this as an impediment to advertising.

#### COMPUTATION METHODS

S. 2421 would also require nonretail credit card issuers, such as banks, to use one particular method—the average daily balance method—in calculating the finance charge, or an alternative method that results in a lower finance charge.

Many of the other terms required to be disclosed, such as the annual fee or the annual percentage rate, are straightforward and easy for consumers to understand. The way the creditor figures the balance to which it will apply the annual percentage rate, however, is not so easily understandable. Consequently, a creditor might satisfy the truth in lending requirement by explaining how it calculates the customer's balance, the customer may not be able to fully appreciate how one creditor's method differs from another.

One approach to this problem is the one taken by S. 2421; that is, to prohibit all balance computation methods except one.

While S. 2421's approach to balance computation may have some appeal, it may affect both the operations and yields of some creditors. If adoption of this approach results in increased operational costs or reduced revenue, the issuer is likely to pass such costs on to its customers in some way or another. It is uncertain, therefore, whether the benefit of having a uniform balance computation method would exceed the associated costs to consumers after such adjustments have taken place.

And we have more fundamental problems with this aspect of S. 2421. Traditionally, balance computation methods, like other yield-producing terms, such as interest rates, the amount of transaction charges, late charges, et cetera, have been regulated by the States. Because the States consider all determinants of the cost of credit in fashioning their regulations, they probably are in a better position

to regulate the balance computation method in relationship to other credit terms. Rate regulation has been an important State function and we suggest great caution in overturning this tradition, particularly on a piecemeal basis.

An alternate approach to the problem is to seek increased consumer awareness of balance computation methods. One way of doing this involves educational efforts on the part of industry and consumer groups.

#### STUDY ON COMPARATIVE COST

S. 2264 would require each credit card issuer to report to the Board on a quarterly basis the average annual percentage rate and any annual or other fee applicable during the preceding quarter. While this idea may seem appealing on initial examination, there are a number of questions about its usefulness and cost that need to be considered. The Federal Reserve is currently analyzing the results of a study conducted at the request of the Congress to measure the benefits of providing consumers with comparative cost information about closed end credit. Its findings should provide a means of better evaluating the use that consumers make of published lists of comparative rate data. The Board suggests postponing action in this area until the results of the demonstration project are available.

In conclusion, Mr. Chairman, the Board believes in full disclosure, both because it is the fair way to deal with consumers and because it aids the competitive process. However, given the extensive disclosures already required by truth in lending when the consumer receives the credit card, and the fact that many credit card issuers already supply much of the proposed information in their solicitations, we are not sure that legislation is needed. On the other hand, we believe that the burden of the disclosure provisions contained in S. 2421 would not be substantial. In contrast, we believe the scope of S. 2140 and S. 2264 is too broad, particularly in that the bills require disclosures in all applications.

With regard to S. 2421, we appreciate the difficulties that some consumers may have in comparing balance computation methods. However, because these methods have been a matter of State law for so long and because they are so intimately tied to other State provisions, we do not favor this portion of S. 2421. In addition, the provision in S. 2264 for reporting credit cost terms to the Board is potentially costly, and until the Board completes its analysis of the demonstration project on closed end credit rates, we cannot be sure about the extent of the benefits of such compilations.

Thank you, Mr. Chairman.

[The complete prepared statement follows:]



I appreciate the opportunity to appear before this subcommittee to discuss the disclosure requirements of three bills dealing with credit card applications and solicitations: S. 2140, S. 2264, and S. 2421. All three bills would add an early disclosure requirement to the Truth in Lending Act for open-end credit card plans. S. 2421 is narrower than the other bills in that it deals only with disclosures in mail solicitations, though it also addresses the balance computation methods used by certain credit card issuers. S. 2264 would also require credit card issuers to report certain cost terms to the Board, and would require the Board in turn to make this information available to the public and to report it annually to the Congress.

Currently, the law requires early disclosures only when creditors engage in advertising. Solicitations for credit are thus subject to some Truth in Lending disclosure requirements, since they are considered "advertisements" under the statute and the Board's implementing regulation, Regulation Z. Whenever certain credit terms are stated in an advertisement, the creditor must give additional information about the credit plan. For example, if the creditor advertises the plan's annual fee, the advertisement must state the annual percentage rate, as well as any other finance charges that may be imposed.

If none of the specified credit terms is stated in the solicitation, however, the law does not require that cost information about the plan be given. Consequently, while the act does at times require that consumers receive cost information with solicitations, the present law does not always require that consumers are given this information before they receive a credit card.

Statement by

Emmett J. Rice

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Affairs

of the

Committee on Banking, Housing, and Urban Affairs

United States Senate

May 21, 1986

Under the current law consumers must, however, be given full disclosure of the terms and conditions of the credit card program no later than the time that they receive the card. Therefore, consumers do have an opportunity to review all of the terms and conditions before using the account. In addition, the regulation provides that a consumer may not be obligated on a credit program prior to receiving complete disclosures; this would include, for example, the obligation to pay an annual membership fee.

The proposed bills go beyond the present act by requiring the creditor to include certain Truth in Lending disclosures in any application or solicitation for a credit card plan, without regard to whether the creditor mentions a particular term. The proposed legislation expands the current statutory requirements for advertising in another way as well. The card issuer would be required to disclose the conditions under which a finance charge may be imposed, including whether or not any time period exists for credit to be repaid without incurring a finance charge; in addition, S. 2140 would require disclosure of the balance computation method.

The issue of how much disclosure to require in advertisements has been considered before by the Congress -- most recently in 1980 when it simplified the Truth in Lending Act. At that time, the Congress cut back on the disclosures required in open-end credit advertisements in the hope that reducing the disclosure burden would promote more advertising, thereby increasing competition. To the extent that the proposed disclosure requirements might discourage open-end credit advertisements, this legislation could have the unintended effect of decreasing rather than increasing competition. We are inclined to think, however, that given the limited scope of the increased disclosure in

S. 2421 it would not have that effect. Our impression is that many card issuers are already including in their mail solicitations much of the disclosure information proposed in the bill, and, presumably, have not viewed this as an impediment to advertising. Requiring disclosure in all applications whether or not the application is part of a mail solicitation -- as the two other bills do -- might have the adverse effect which the Congress sought to avoid in 1980.

Increased disclosure requirements invariably result in some increased costs to the industry. Additional costs resulting from S. 2421 would probably not be substantial, given that it focuses on the narrow area of mail solicitations. In mail solicitations creditors should be able to include current disclosure information without significant burden, since such solicitations are usually offered for a limited time with stated expiration dates. Broader legislation, as suggested by S. 2140 and S. 2264, that would require disclosures in all applications for open-end credit cards -- not just in mail solicitations -- could prove to be operationally difficult for card issuers and could result in costs that exceed consumer benefits. For example, card issuers would have to reprint credit card applications when the terms of their credit card plans change. The burden would vary depending on the creditor, however. National banks offering their credit cards nationwide, for example, may be able to have uniform credit terms so that a single solicitation or application would apply to all prospective cardholders. Retailers, in contrast, are generally subject to individual state laws, which would make the use of uniform nationwide documents more difficult. In addition, the burdens associated with additional disclosure requirements would probably be greater for small institutions.

The Truth in Lending Act and Regulation Z mandate that creditors disclose which balance computation method they intend to use -- and provide an

- 5 -

with the disclosures required by the act and the regulation. Consequently, while a creditor might satisfy the Truth in Lending requirement by explaining how it calculates the customer's balance, the customer may not be able to fully appreciate how one creditor's method differs from another -- and, consequently, how the difference might affect the amount of the finance charge.

One approach to this problem is the one taken by S. 2421: that is, to prohibit all balance computation methods except one. The purpose of such an action, presumably, would be to standardize that feature of credit card programs, so that consumers no longer would have to consider this particular term when comparing credit card programs.

While S. 2421's approach to balance computation may have some appeal, it may affect both the operations and yields of some creditors. If adoption of this approach results in increased operational costs or reduced revenue, the issuer is likely to pass such costs on to its customers in some way or another. Thus, regulating the balance computation method area might result in restricted credit availability, the elimination of grace periods, or higher interest rates, annual fees or merchant discounts. It is uncertain, therefore, whether the benefit of having a uniform balance computation method would exceed the associated costs to consumers after such adjustments have taken place.

And we have more fundamental problems with this aspect of S. 2421. Traditionally, balance computation methods -- like other yield-producing terms, such as interest rates, the amount of transaction charges, late charges, etc. -- have been regulated by the states. In fact, over the years many states have specified the permissible balance methods as one aspect of their overall rate regulation. Because the states consider all determinants of the cost of credit in fashioning their regulations, they probably are in a better position

- 4 -

explanation of how that method works. The creditor must provide this information in its initial disclosure statement and must repeat it on each monthly bill.

S. 2421 would also require nonretailer card issuers, such as banks, to use one particular method -- the average daily balance method -- in calculating the finance charge, or an alternative method that results in a lower finance charge.

In general, the Truth in Lending Act does not involve the substantive regulation of credit terms, such as the rate of interest that can be imposed or the types of charges that are permissible. Rather, the focus of the act is on ensuring that consumers receive the most important credit information before becoming obligated. By venturing into the substantive regulation of credit terms via the Truth in Lending Act, the provisions of S. 2421 dealing with balance computations would be a departure from the current approach.

Over the years creditors have used various balance calculation methods for their open-end credit plans, some of which generally produce higher monthly finance charges than others. The "previous balance" method will often result in higher finance charges for consumers, for example. However, the timing of a customer's purchases and payments can influence which balance computation method results in the lowest finance charge. In addition, even within a single balance computation method, such as the average daily balance method, there are variations in how favorable or unfavorable one creditor's method may be to the consumer compared to another creditor's.

Many of the other terms required to be disclosed, such as the annual fee or the annual percentage rate, are straightforward and easy for consumers to understand. The way the creditor figures the balance to which it will apply the annual percentage rate, however, is not so easily understandable -- even



to regulate the balance computation method in relationship to other credit terms. Moreover, Federal legislation of the balance computation method could be viewed as the beginning of Federal control of a host of other terms -- such as rebate methods and delinquency charges -- that have long been controlled by the states. Rate regulation has been an important state function and we suggest great caution in overturning this tradition, particularly on a piecemeal basis.

An alternate approach to the problem is to seek increased consumer awareness of balance computation methods. One way of doing this involves educational efforts on the part of industry and consumer groups. A pamphlet dealing with how to shop for a credit card, for example, was just released by the American Institute of Certified Public Accountants in cooperation with the U. S. Office of Consumer Affairs, and we expect it will receive wide distribution. As another example, the Federal Reserve prepares educational materials and conducts presentations for teachers and other groups regarding consumer credit, including credit cards. The Federal Reserve Bank of Minneapolis has developed instructional materials for secondary school teachers, and is currently preparing additional material dealing with credit cards, including balance computation methods. These and other educational efforts should help alert consumers to the fact that differences in credit programs do exist and that "shopping around" may save them money.

S. 2264 would require each credit card issuer to report to the Board on a quarterly basis the average annual percentage rate and any annual or other fee applicable during the preceding quarter. While this idea may seem appealing on initial examination, there are a number of questions about its usefulness and cost that need to be considered. The Federal Reserve is currently analyzing

the results of a study conducted at the request of the Congress to measure the benefits of providing consumers with comparative cost information about closed-end credit. While this demonstration project did not address credit cards, its findings should provide a means of better evaluating the use that consumers make of published lists of comparative rate data. In view of the costs associated with the collection and dissemination of comprehensive information about rates and fees from thousands of credit card issuers, the Board suggests postponing action in this area until the results of the demonstration project are available.

In conclusion, Mr. Chairman, the Board believes in full disclosure -- both because it is the fair way to deal with consumers and because it aids the competitive process. However, given the extensive disclosures already required by Truth in Lending Act when the consumer receives the credit card, and the fact that many card issuers already supply much of the proposed information in their solicitations, we are not sure that legislation is needed. I might add that our files do not show any consumer complaints on the matter. On the other hand, we believe that the burden of the disclosure provisions contained in S. 2421 would not be substantial. In contrast, we believe the scope of S. 2140 and S. 2264 is too broad, particularly in that the bills require disclosures in all applications.

With regard to S. 2421, we appreciate the difficulties that some consumers may have in comparing balance computation methods. However, because these methods have been a matter of state law for so long, and because they are so intimately tied to other state provisions, we do not favor this portion of S. 2421. In addition, the provision in S. 2264 for reporting credit cost

- 8 -

terms to the Board is potentially costly, and until the Board completes its analysis of the demonstration project on closed-end credit rates, we cannot be sure about the extent of the benefits of such compilations.

Senator GORTON. Thank you, Governor Rice. As I said, we are always happy to have you here. I can only comment that it seems to me that the position of the Federal Reserve Board would be analogous to telling those who solicit to sell insurance policies that they could do so without telling the potential customer either the face amount of the insurance policy or the premium, and that it would be perfectly appropriate if those two facts were only disclosed after you had ordered the policy and received it.

But except for that comment, I will, because of the constraint of time, submit my questions to you in writing and turn you over to the tender mercies of Senator D'Amato.

Senator D'AMATO. Mr. Chairman, first, I would ask that a copy of the Nilson Report that I alluded to before be included in the record.

Senator GORTON. Without objection.

[The following report and responses to questions of Senators Gorton and D'Amato were subsequently submitted for the record:]

THE NILSON REPORT  
MARCH 1985

| HOW BANK CARDS MADE MONEY IN 1984     |                   |                                |                            |                  | TOTAL CARDS: 102,446,000          |                        |                |
|---------------------------------------|-------------------|--------------------------------|----------------------------|------------------|-----------------------------------|------------------------|----------------|
| Average Outstandings \$87,247,000,000 |                   |                                |                            |                  | Total Accounts: 109,048,000       |                        |                |
|                                       |                   |                                |                            |                  | Active Accounts (725): 75,590,000 |                        |                |
| INCOME                                | % of Outstandings | Source                         | Amount                     | % of Total       | Revolving 97.8%                   | Convenience 2.2%       |                |
|                                       | 16.35%            | Interest Charges (@ 13.37%)    | \$10,993,904,000           | 63.09%           | \$10,993,904,000                  | \$ ---                 |                |
|                                       | 4.35%             | Net Merchant Income            | 3,281,189,000              | 18.71%           | 2,211,086,000                     | 1,050,103,000          |                |
|                                       | 2.89%             | Annual Fees (@ \$18.51)        | 1,943,265,000              | 11.15%           | 1,317,534,000                     | 625,731,000            |                |
|                                       | 1.83%             | Other Fees/Penalties           | 1,230,510,000              | 7.06%            | 1,230,510,000                     | ---                    |                |
|                                       | 25.92%            | Total                          | \$17,428,868,000           | 100.00%          | \$15,753,034,000                  | \$ 1,675,834,000       |                |
|                                       |                   |                                |                            |                  |                                   |                        |                |
|                                       | EXPENSE           | 9.24%                          | Money                      | \$ 6,213,068,000 | 41.96%                            | \$ 5,444,451,000       | \$ 768,617,000 |
|                                       |                   | 2.19%                          | Credit Losses              | 1,471,074,000    | 10.65%                            | 3,943,483,000          | 1,072,864,000  |
|                                       |                   | 1.94%                          | Merchant Sales & Servicing | 1,395,225,000    | 9.45%                             | ---                    | ---            |
| 1.35%                                 |                   | Advertising & Promotions       | 905,322,000                | 6.55%            | 1,172,800,000                     | 615,200,000            |                |
| 1.34%                                 |                   | Credit Reports & Processing    | 898,339,000                | 6.50%            | ---                               | ---                    |                |
| 1.31%                                 |                   | Statement Billings             | 877,763,000                | 6.35%            | ---                               | ---                    |                |
| 0.67%                                 |                   | Cardholder Services            | 451,638,000                | 3.27%            | ---                               | ---                    |                |
| 0.53%                                 |                   | Collection & Overlimit Control | 355,961,000                | 2.58%            | ---                               | ---                    |                |
| 0.47%                                 |                   | Fraud Losses                   | 316,926,000                | 2.29%            | ---                               | ---                    |                |
| 0.47%                                 |                   | Fraud Investigation            | 315,323,000                | 2.28%            | ---                               | ---                    |                |
| 0.32%                                 |                   | Visa/MasterCard Fees           | 218,617,000                | 1.58%            | ---                               | ---                    |                |
| 0.29%                                 |                   | Card Issuing                   | 198,559,000                | 1.44%            | ---                               | ---                    |                |
| 0.24%                                 |                   | Credit Authorization           | 162,548,000                | 1.18%            | ---                               | ---                    |                |
| 0.19%                                 |                   | Enhancements                   | 127,055,000                | 0.92%            | ---                               | ---                    |                |
| 20.53%                                |                   | Total                          | \$13,817,415,000           | 100.00%          | ---                               | ---                    |                |
|                                       |                   |                                |                            |                  |                                   |                        |                |
| NET                                   | 5.37%             | Net Before Taxes               | \$ 2,611,453,000           | ---              | ---                               | ---                    |                |
|                                       |                   |                                |                            |                  | Gain Per Card \$47.44             | Loss Per Card -\$30.41 |                |
|                                       |                   |                                |                            |                  | Average Profit Per Card \$22.37   |                        |                |

Profit  
\$ 5,192,300,000  
(109,459,000 Cards)Loss  
\$ 1,580,347,000  
(51,985,000 Cards)Gain Per Card  
\$47.44Loss Per Card  
-\$30.41Average  
\$23.27  
Profit Per Card

Governor Rice's Responses to Senator Gorton's Questions

Q.1. You note that retailers are generally subject to the disclosure laws of the individual states, and so might have more difficulty complying with a federal disclosure requirement than would banks, which are typically subject to only a single state's requirements. What then, is the Federal Reserve's recommendation? Should we preempt state disclosure statutes for these solicitations, or should we drop retailers from the bill?

Answer: When we stated in our testimony that retailers may have more difficulties with disclosing their credit card terms, we were referring to the fact that they are generally subject to the laws of the states in which their customers reside, unlike national banks which are able to export the credit card interest rate that is allowed by the state in which they are located. (This ability of national banks is based on § 85 of the National Bank Act and the Supreme Court's decision in Marquette National Bank vs. First Omaha Service Corp., 439 U.S. 299 (1978).) As a result of this difference, some retailers will be required to disclose multiple credit terms under the different state laws, while national banks would be able to impose and disclose, for example, one annual percentage rate for the entire country. Thus, the burden associated with the new disclosure requirements might be greater for retailers.

In our opinion, preempting state disclosure laws would not address the potential problem since the differing state laws regarding credit terms are the source of the potential problem.

We do not believe that the compliance problems for retailers are so great as to warrant exempting retailers from the bill. This is particularly the case if the bill continues to require disclosures only in mail solicitations.

- 2 -

Q.2. Some retail cards, such as J.C. Penney's, can be used for credit at locations other than the parent retailer, though the predominance of their use is at the parent company. In your opinion, is there any ambiguity over whether such cards are covered by the balance calculation requirement of S. 2421, which applies to credit extended by a party "other than the provider of goods and services?"

Answer: While it could be argued that the language is unclear, our reading of S. 2421 did not lead us to conclude that retail credit cards that can be used for credit at locations other than the parent retailer were subject to the balance computation requirement in S. 2421. Any such ambiguity could be dealt with by the implementing regulations.

Q.3. Would you recommend that disclosures apply to credit plans which are not associated with a credit card? For example, the replicas of checks that are mailed to consumers telling them they have a "Guaranteed \$2,000" if they bring the check in, but which fail to disclose the annual percentage rate.

Answer: I believe that many of the factors you stated in introducing S. 2421 may be applicable to both open-end and closed-end credit plans which do not involve credit cards. As a result, the Congress could consider requiring disclosure of the most important credit terms in any mail solicitation for credit regardless of whether a credit card is involved.



Q.4. Several witnesses have urged that any disclosure requirements amend Section 143 of the Truth in Lending Act, and not Section 127. What are the implications of this change? Do you recommend amending Section 143 or Section 127 with disclosure requirements for solicitations?

Answer: Solicitations to join credit card programs are considered advertisements as that term is defined by Regulation Z. The regulation defines the term "advertisement" in order to implement Truth in Lending's section 143 which sets out disclosure rules for creditors to follow when advertising open-end credit plans. Since S. 2421 is aimed at a certain type of advertising -- that is, mail solicitations -- it seems more appropriate to include any new rules on advertising in section 143, rather than in section 127; the latter section lists the disclosures required to be given to the consumer before any open-end credit account is opened -- regardless of whether the consumer joined the credit program as a result of a mail solicitation. Placing the new rules of S. 2421 in the advertising section of the statute will indicate clearly the steps card issuers must follow at the early stage of credit solicitation, while in no way confusing them about the separate requirement to comply with the additional disclosure rules of section 127 before opening a consumer's account. However, placing the provision in § 143 will result in there being no civil liability for violation of any new disclosure requirements. (The Truth in Lending Act does not provide for civil liability for violations of the advertising provisions. See § 130 of the act.)

## Governor Rice's Responses to Senator D'Amato's Questions

Q.1. Mr. Rice, you've appeared at two hearings on this subject so far and have been very critical of any legislation that initially would place a floating ceiling on credit card interest rates or require additional disclosure. Much of your criticism has been based upon free market arguments and the fact that the market is already very competitive. Despite your claims that the market is competitive, let me cite you a statistic from the Nilson Report. According to the Nilson Report, bank card issuers earned 5.3% profits on bank cards while the average profit on the overall lending activities of banks in 1985 was .98%. The fact that banks earned 5 times more on bank card activity than other lending activity suggests a lack of competition in the marketplace to me, what does it suggest to you?

Answer: In response to your first question, let me review some of the facts that seem to point toward active competition in the credit card market. First, the number of credit card issuers is quite large. Banking industry surveys indicate that in 1984 approximately 10,000 commercial banks offered credit cards. Also, thousands of individual retailers around the country issue their own credit cards. In addition, most of the larger gasoline retailing companies offer credit card services. There are several general purpose credit cards that are widely accepted, and more specialized credit cards for use by airline and car rental customers. Given the large number of alternative sources of credit card services, the existing market conditions seem to be conducive to active competition among credit card users.

Other signs of robust competition in the credit card market include entry by new credit card plans, including the Sears Discover Card that is being offered nationwide. Entry by thrift institutions and credit unions into the credit card market has been quite active in recent years, partly as a result of expanded consumer lending powers that these institutions acquired in 1980.

Also, as you know, many bank credit card issuers have broadened the geographic scope of their services by seeking new customers in other areas. Therefore, it seems unlikely that credit terms available in local market areas

could remain too far out of line for very long with those being offered by banks from other areas that are seeking to attract new customers.

In this connection, one point that often seems to be overlooked is the variety of ways in which credit card competition takes place. There appears to be a tendency to focus mainly on finance rates as the sole criterion for judging competition. However, depending on the way a cardholder uses the credit card, other credit terms may overshadow the finance rate in importance as determinants of the cost and usefulness of a particular credit card plan. For example, about half of all credit card holders usually pay off their entire balance within the interest-free grace period, and therefore incur only minimal, if any, finance charges. For these customers, the finance charge presumably is much less important than other features of the credit card such as the credit limit, the annual fee, and other charges, if any, and the credit qualifications that must be met to obtain the credit card. Accordingly, credit card issuers can compete actively by varying these other dimensions in addition to, or instead of, adjusting the finance rate, depending on the type of credit card user to whom they wish to appeal. Given the large number of credit card issuers, it seems likely that a number of alternative sources offering different combinations of features would be available in most areas.

As your question suggests, there is another important aspect of competition in the credit card market -- the level of profits on credit card operations. The best information available on this subject comes from the Functional Cost Analysis that the Federal Reserve System conducts annually. Since there can be wide variation in profits on any type of lending from year to year, and since the banks that participate in the FCA also vary, the results of a profit comparison are more reliable if they are based on average results

for several years rather than on data for a single year that might be distorted by unusual circumstances. Functional Cost data for bank credit card plans for the period 1972 through 1984 show that annual net earnings before taxes averaged only 1.68 percent of balances outstanding. In comparison, net returns on other major types of commercial bank lending were significantly higher; net earnings on real estate mortgage loans averaged 2.24 percent and net returns on consumer installment loans and on commercial loans averaged 2.32 percent and 2.91 percent, respectively. Therefore, the best evidence as to profitability indicates that credit card profits have not been out of line with returns on other major types of bank lending.

With regard to profitability, the two statistics to which your question refers are not comparable, as explained below. As a result, their relative size does not provide a reliable insight into the degree of competition in the bank credit card market.

The Nilson Report estimate is based on a one-time survey of larger banks that offer credit cards. The approach taken was deliberately selective, and no claim was made to represent the profitability of all commercial banks that offer credit cards. Also, the Nilson Report sampling could not obtain from all the banks that were surveyed information on all of the relevant cost and revenue items for credit card operations. Furthermore, the sampled banks did not maintain their accounting systems in uniform ways. Therefore, data were included or excluded on the basis of whether the information seemed reasonable; and various categories reportedly were combined or regrouped in ways that appeared to result in greater uniformity of treatment. Of course, any estimate derived without applying rigorous statistical procedures and with judgmental editing of data is likely to be subject to considerable error.

The other statistic referred to in your question -- "the average profit on overall lending activities of banks in 1985" of 0.98 percent -- is of an entirely different nature from the Nilson Report estimate. It is based on information for all U.S.-chartered insured commercial banks in the first three quarters of 1985. The denominator of the ratio consists of total assets of U.S. commercial banks, averaged over the period. Since assets is a substantially broader concept than loans outstanding, the use of assets as a denominator produces a lower ratio. Moreover, the numerator of the ratio is the profit before taxes earned by U.S. commercial banks on all operations, both domestic and foreign, not just on lending activities. This measure includes not only net interest income from loans and investments, but also gains on investment account securities and noninterest income from activities such as trust department and deposit account services, among others. Given the fact that many of these other activities involve much lower risk than credit card lending, overall net earnings would be expected to be lower as a proportion of assets for all bank functions combined than credit card earnings would be in relation to the assets allocated to the credit card function.

Equally important to the level of profitability, in my view, is the decline that has been occurring in credit card rates. Average rates on credit card plans at commercial banks have come down slowly during the past year, and announcements of rate reductions seem to be occurring more frequently these days. The average rate on bank credit cards in early May, as reported by a sample of commercial banks, was 18.32 percent, down 0.16 percentage points from February. Thus, it appears that competitive pressures have been pushing rates downward, and that any unusual rise in credit card profits is unlikely to persist.

Q.2. On page 7 of your testimony you state that disclosures are already extensive and you haven't received any consumer complaints. What did you expect them to complain about? That really isn't the point is it? The real point is how can consumers readily compare card interest rates or have access to lists of the lowest card rates in the country. I think that the provisions in my bill that require the card issuers to report certain information to the Fed and for the Fed in turn to report this annually to the Congress or to the public upon request will provide consumers access to this information that they really want. And believe me they want it since my office has received over 100,000 inquiries on this subject. How do you respond to that fact?

Answer: The remarks in our testimony concerning the fact that extensive disclosures are already made under Regulation Z and that we have not received any consumer complaints are, in our view, relevant to the question of whether new disclosure requirements are needed. As indicated in the testimony, these points lead us to be unsure of the need for additional disclosures.

As for what consumers would complain about if they did complain about the lack of credit card cost information in solicitations and applications, we would expect consumers to complain about the amount of the fees and charges, or the annual percentage rate, applicable to use of the card -- facts that they were not aware of until after they received the card. As mentioned in our testimony, we have not received such complaints.

The fact that your office has received over 100,000 inquiries on the subject of credit card plans that offer low finance charges does indicate that many consumers are interested in information about low cost credit card plans. However, we are not sure that publication by the Federal Reserve Board of a credit card shoppers guide that contains information on well over 10,000 card issuers (many offering several different credit card plans) will help consumers. The amount of information that would be in the guide would make it difficult for consumers to use, and make the guide expensive to compile and distribute. In addition, we are concerned that such a guide could provide incomplete and



misleading information to consumers, and lead to consumers applying for credit cards with credit card issuers who would not accept them.

For example, the credit card shoppers guide as envisioned would not indicate that many card issuers restrict the number of applicants they accept or that many impose strict qualifying standards such as "customer only" policies, geographic limits or significant minimum income standards. These restrictions would result in consumers often applying for cards for which they could not possibly qualify. Provision for such qualifying information in the shoppers guide, or for more complete information on available terms (such as rebates, travel discounts, and automatic insurance coverage, for example) could substantially complicate the guide -- thereby detracting from its potential usefulness -- as well as increase the cost of its preparation.

We continue to believe that the costs of collecting, compiling, and distributing the information on credit card terms -- even though they may not be great for card issuers -- would be significant for the Federal Reserve Board. As a result, unless the shoppers guide is going to be useful and provide consumer benefits, we believe the costs of the guide could exceed its benefits.

As noted in our testimony this past May, the Federal Reserve believes that final judgment on the advisability of incurring the costs of preparing and distributing credit card comparative price lists should be deferred until the results of the Annual Percentage Rate Demonstration Project become available this fall. This study deals with shoppers guides for closed-end credit loans, and should provide information that will help evaluate the benefits and costs of preparing and distributing credit card shoppers guides.

## BURDEN OF DISCLOSURE

Senator D'AMATO. Governor Rice, let me ask you, you mentioned that possibly we ask for too much disclosure and that it might be a burden.

What disclosure under S. 2264 do you think is inappropriate? For example, S. 2264 requires that the annual fee be disclosed. Do you think that's too burdensome or should that information be made available? Should the annual fee be made available?

Mr. RICE. Senator, as we stated in the testimony that we submitted, we favor disclosure.

Senator D'AMATO. Should the annual fee, Mr. Governor, should that be one of the aspects that is disclosed?

Mr. RICE. In mail solicitation, yes.

Senator D'AMATO. Well, what about the annual fee when a person picks up an application from the bank or from a credit card company or from any institution? Are you suggesting that the annual fee be disclosed only in mail solicitations? Are you stating that it's too great a burden to disclose this to a person who goes into an institution, picks up a counter solicitation at a Sears Center, or a bank or any other institution, you mean to tell me its too much of a burden to be disclosed whether the fee is \$20 or \$30?

Mr. RICE. No. Senator, I just said the annual—

Senator D'AMATO. I know you just told me that, yes, in mail. Let me ask you this then. What about if a person comes and applies—and I would gather that most applications are received in person where people do their financial business, et cetera. Should a consumer who comes to a counter and makes application know what the annual fee is? Is that a burdensome requirement? Should it be there?

Mr. RICE. Applications are available at any number of places. Many of them are available in magazines. Many of them are available in restaurants. These applications are spread out all over the place.

Senator D'AMATO. And should the annual fee be a part of it?

Mr. RICE. And let me just finish the statement. The terms on which these credit solicitations are offered may change and then the information on applications would be out of date. Under your proposal you would have a situation where credit terms that are no longer current would be stated on applications and a lot of confusion, a lot of misunderstanding, could develop as a result of that.

Senator D'AMATO. So therefore, the annual fee—

Mr. RICE. Just to answer you directly, of course, I'm in favor of people knowing what the annual fee is.

Senator D'AMATO. OK.

Mr. RICE. I was simply pointing to a problem that is associated with requiring that that information be put on applications.

Senator D'AMATO. You mean to tell me that if there's an application that a person shouldn't know that there's an annual fee and what that fee is?

## FED FAVORS DISCLOSURE

Mr. RICE. I didn't say they shouldn't know. It would be very nice if they knew. It would be a good thing if they knew.

Senator D'AMATO. Wonderful. So that you're not opposed to the disclosure of an annual fee?

Mr. RICE. I said that I was not.

Senator D'AMATO. Whether it's in the mail or whether it's an application you pick up at the institution?

Mr. RICE. I'm not opposed to disclosure of the annual fee.

Senator D'AMATO. What about the grace period, in other words, when the interest starts to run?

Mr. RICE. I am certainly not opposed to that.

Senator D'AMATO. So that people should know that the interest payments that they may be charged immediately or there may be a grace period that there's no interest until 20 days or 30 days? That's relevant, isn't it?

Mr. RICE. I'm in favor of disclosing such information.

Senator D'AMATO. And what about the interest charges, the rates?

Mr. RICE. I'm in favor of that, too.

Senator D'AMATO. So you're in favor of them getting that information whether they apply by mail or whether they apply in person, all that information should be made available to them. So that aspect of S. 2264 you're not opposed to. But you did mention that you're concerned about the cost factors and that S. 2264 may be too broad as it relates to reporting four times a year to the Federal Reserve what those three costs are; is that correct?

Mr. RICE. That's correct.

Senator D'AMATO. Do you really believe that an institution is being unduly burdened if four times a year it has to report to the Federal Reserve what these three areas are—grace period, interest rates, annual fee? Is that an undue burden on an institution?

Mr. RICE. I was speaking of the entire burden, not just to the institution but to the Federal Reserve as well. But let me say first that four times a year might be too frequent. Terms probably don't change often enough to—

Senator D'AMATO. How about twice a year?

Mr. RICE. That would be better than four times a year.

Senator D'AMATO. Would you support twice a year?

Mr. RICE. But, as I said, I was talking about the entire burden. The burden to the Federal Reserve of collecting all this information. There would be upward of 7,000 financial institutions, banks, reporting this information.

Senator D'AMATO. Well, they report to you every day now, don't they?

Mr. RICE. There would be thousands of retailers, the nonfinancial institutions, reporting. The Federal Reserve would have to compile all this information and have to figure out a way to distribute it.

Now it is true that we collect a lot of information from financial institutions, but it's also very, very costly.

Senator D'AMATO. Sure.

Mr. RICE. And it's very, very burdensome on the financial institutions.

Senator D'AMATO. All right. Let's concede for the moment that a report four times a year from an institution, some of which report to you daily, to the Federal Reserve may be burdensome—what about—

Mr. RICE. There are very few institutions that report to us daily. Senator D'AMATO. Four times a year is burdensome to them. What about twice a year?

Mr. RICE. That would be less burdensome.

Senator D'AMATO. How burdensome would twice a year really be, and don't you think the American public is entitled to get this information? How do they get this information if no one—if you take this position that, yes, they should have this information you agree that they should have to the consumers? How do we get it to them?

Mr. RICE. Well, I think that's a problem.

#### REPORTS FROM THE FED TWICE A YEAR

Senator D'AMATO. Wouldn't one of the ways be to require these issuers to report to the Fed twice a year and in turn have the Fed report that information to the Congress twice a year or once a year. Then the Congress could make this information available and the various consumer groups could come and could see and the private sector could pick up this information and the consuming public would have this made available to them with a great deal more ease, do you really think that's an undue burden?

Mr. RICE. Not on the institutions so much as on the Federal Reserve itself. Also, as I said, the problem of compilation and the problem of distribution, it would be like issuing a telephone book. It's also a question of the use that the consumers would put this information to, and I think that before we do all this we should at least look at the results of the demonstration project.

Senator D'AMATO. When will the demonstration project results be completed?

Mr. RICE. We expect this fall.

Senator D'AMATO. This fall. Well, Mr. Chairman, I want to thank you for the opportunity you've given me.

Mr. RICE. I'd just like to go over one thing. Again, we have established that as it relates to those provisions in S. 2264 that call for the disclosure of the grace period, the interest rate, and the annual fees, that you're not opposed to that?

Mr. RICE. No, I'm not opposed to disclosure of those things.

Senator D'AMATO. But the only thing that you're questioning is whether or not these institutions should be required to report to the Federal Reserve as the method by which the Federal Reserve then reports to the Congress, compiles this list and reports what these fees are for the various institutions, that you have a question on?

Mr. RICE. Yes. I'm saying that there are costs as well as benefits to the proposal and—

Senator D'AMATO. Well, wait—cost to the public?

Mr. RICE. I said there are costs to collecting, compiling, and distributing.

Senator D'AMATO. Who is that cost borne by that we're talking about now, the cost that you're concerned with?

Mr. RICE. It's borne primarily by the Federal Reserve and, second, it's borne to some extent by the reporting institutions.

Senator D'AMATO. Well, you mean to the extent that twice a year they would have to give three numbers—right, three numbers



twice a year—so we're talking about \$1, \$2, \$3 a year. Is that what you're talking about?

Mr. RICE. We're also talking about thousands of institutions.

Senator D'AMATO. Now wait a second. We're talking about each institution twice a year reporting to the Federal Reserve and you're trying to suggest that that should be some way of mitigating the benefits that are given by disclosure to bring about competition? Because I reject that, Mr. Rice. I think that is absolutely absurd. It's absurd. If you want to suggest that there is some cost associated with us taking this information once a year or twice a year from thousands of institutions, compiling it and passing it on to the Congress, I understand that; but don't suggest that the consumer is going to pay some kind of a burden because the institution, the bank, has to send this information twice a year to the Federal Reserve. That's ridiculous.

Mr. RICE. I am saying there are substantial social costs in reporting all this information. There are substantial financial costs to the Federal Reserve.

Senator D'AMATO. Substantial social costs?

Mr. RICE. Yes.

Senator D'AMATO. What do you mean by that?

Mr. RICE. If you add up the time and resources placed into reporting by thousands of institutions, perhaps even 10,000 institutions, if you add all that up, that's a substantial amount of resources.

#### CONSUMERS BEING OVERCHARGED

Senator D'AMATO. What about the substantial amount that consumers are being overcharged? It seems to me that you don't give two hoots and a holler about the fact that they are being charged nationally 18.6 percent but you're worried about a bank twice a year sending three numbers to the Federal Reserve. You have gone to great lengths to talk about the social cost, the time to 10,000 institutions have, but the hundreds of millions of card holders, the working middle-class families who are paying billions of dollars over and above what they should be, you don't even talk about them. What about the social and economic costs they bear through payment of usurious interest rates?

Mr. RICE. I am also concerned about the financial cost to the Federal Reserve.

Senator D'AMATO. I have to tell you, Mr. Governor, I find—

Mr. RICE. I am also concerned about how useful this information will be to the consumer when compiled and distributed.

Senator D'AMATO. Well, if the Federal Reserve did a little something on their own and went out there and assembled this information, instead of this worthless study that you're going through, you could do it in 1 day. You should be able to get that information and disseminate it to the Congress or disseminate it to the consumer groups. We wouldn't and shouldn't have to be asking for this. But instead what you do is look to be a roadblock, you look to impede it. You don't want to give the people this information, and you come here and testify as if you're working for the credit card institutions by seeming to say to heck with the American public.

Then you say let the free marketplace work. Well, lack of information impedes the marketplace. I don't understand your position. I have to drag out of you that reluctantly, yes, you would be for the interest rate disclosures; yes, you'll be for the grace period; but you don't say that in your testimony. You do everything to impede disclosure—I have to draw it out of you in this manner and cross-examine you. I don't understand your attitude.

Mr. RICE. We said in our testimony that we favored disclosure.

Senator D'AMATO. You say it, but then you wonder whether or not we should do it in this manner and we should only maybe do it by mail and ignore the methods of disclosure.

Thank you, Mr. Chairman.

Senator GORTON. Thank you, Governor Rice. We appreciate your appearance here today.

The previous hearing on this subject took place on January 28 and late in the morning we suffered the disaster of the space shuttle *Challenger* and thus were not able to hear from the consumer representatives. Because we have limited time today, I am going to change the order of the two panels and hear next from Mr. Fox and Mr. Holstein so that we are certain that we give them a chance.

We will ask both of you and our further witnesses to limit your oral statements to 5 minutes. Your full written statements will be included in the record as if read.

With that, Mr. Fox, we'll start with you.

#### STATEMENT OF ALAN FOX, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. Fox. Thank you, Mr. Chairman. My name is Alan Fox. I'm legislative representative for Consumer Federation of America, which is the Nation's largest consumer advocacy organization with a membership of over 200 national, State, and local consumer, rural, labor, cooperative, senior citizen, and other groups, that together have over 30 million individual members and we certainly appreciate the opportunity to testify on these bills and appreciate your changing the order so that we could have a chance to get some time in.

I brought with me a number of mailed credit card solicitations. I was going to spend some time on those, but since our time has been cut to 5 minutes I won't, except to show you how expensive these things already are. This is one from Choice, a very fine outer envelope. It's got very expensive paper for all the envelopes and a nice four-color slick paper brochure, a two-page letter printed on both sides. This costs a fair amount and I'm showing it for two reasons. One is there is nothing in here about interest rates, grace periods. There is a disclosure that there is no annual fee. Obviously, that's something the bank would want to disclose under those circumstances.

But I'm showing it for another reason. That is, I find ridiculous the argument that there's going to be a cost burden to banks and other credit card offerers if they're required to make the very minimal sorts of disclosures that these three pieces of legislation propose.



The fact is that these solicitations—and I've got them here from Choice, from Chase Manhattan, from Citibank, these are expensive packages of mail with many pieces of paper in them, very well printed. I've worked in political campaigns. I don't think any of you gentlemen have used brochures as expensively produced as some of these slick statements that are in here.

I think all of these mailings have lots of room and lots of opportunity to disclose a very minimal amount of information to consumers.

#### FOUR KEY ELEMENTS TO PRICING

There are four key elements to pricing and Senator D'Amato discussed three of them and the legislation before us deals with another one.

First of all, there's the annual fee or in some cases another periodic rate or a per transaction rate that's used to substitute for or supplement an annual fee.

Second, there's the interest rate.

Third, there's the grace period or the lack of grace period.

Finally, there's the balance that's used to calculate finance charges.

Now the first three of those are very, very easy to disclose. They are easy to compare and they take up very little room, just as there's not any burden on the bank to put these three pieces of information on a postcard—it would take a small postcard to send it into the Federal Reserve, it would also take very little space to disclose that sort of information and to disclose it clearly and conspicuously on these solicitations.

But I want to spend most of my time addressing the fourth issue, which is the issue of the balance calculation method because those methods don't lend themselves to easy solutions through disclosure.

One key reason for that is that consumers don't understand the implications of the different methods that are available. The report that was put together by the University of Virginia School of Business Administration calculates the cost that consumers might bear under four different balance calculation methods permitted by Virginia law and finds that the variation in finance charges could vary by as much as a factor of four. And that's an effect that's vastly greater than even the extreme differences in interest rates that are available in some parts of the market.

Probably more importantly, purportedly identical methods of calculating balances can yield very, very different results. I was assuming that I would be appearing after the American Bankers Association so I looked at their statement and wanted to rebut something which they will say in their report. Their testimony says that a table in that University of Virginia report shows that three banks using the average daily balance achieve very similar results when calculating average daily balance based on one account scenario—\$426.52, \$437.96, and \$424.03.

Well, I have that table here and in fact that \$426.52 figure is an intermediate step. It's not the final result and this chart very clearly says that three banks using what all purport to be an average daily balance method came up with results of \$424.03, \$437.96, and

\$810 for the balance on which a consumer would have to pay, in this case 18 or 21 percent interest.

So differences in calculation methods that go under the same broad heading can vary the amount of finance charge in this case by a factor of almost 100 percent, the balance that was calculated in one instance almost doubling the balance that was calculated in another.

That means that a very brief disclosure of a balance calculation method, just saying disclose that it's average daily balance, disclose that it's end-of-month balance, is going to be meaningless, it's going to be misleading to consumers, and it's going to reward those deceptive offerers of credit cards who build into their technique, techniques such as the one that produced that high balance.

If we were to require disclosure of method in sufficient detail to allow comparison, that obviously would be burdensome to everyone involved. The particular disclosure that's provided by this one bank takes about two pages of single-spaced typed description to come up with this bizarre description of average daily balance.

#### STANDARDIZE BALANCE CALCULATION METHODS

Consequently, we strongly support the provisions of S. 2421 that standardize balance calculation methods. We believe that if you eliminate the differences in balance calculation methods that's going to force competitors to compete on the basis of those factors which are easy to compare and it's going to make price competition much more meaningful to consumers if that's eliminated as a difference between cards, that competition must focus on easily understood and easily compared terms.

If balance calculation methods are not standardized, then all of the other simple and direct disclosures that are suggested by the three bills will fall far short of allowing consumers to shop and fall far short of allowing consumers to force lenders to compete.

A failure to standardize balance calculation methods is a little bit like requiring retailers to post their prices but allowing them to define weights and measures any way they want. We have had fair weights and measures laws since biblical times. It seems to me that the balance calculation method issue here is the credit card version of fair weights and measures.

So we endorse the requirement that card issuers use an average daily balance method and to eliminate abuses such as the one that's documented in the University of Virginia report. We urge you to explicitly define the method as one which very tightly would prohibit the sort of retroactive calculation of interest that's covered there.

There are a number of other differences between the bills. We've discussed those in the written testimony. I want to commend the subcommittee and the sponsors of all three bills for advancing these very modest and balanced approaches to credit card pricing which will let the consumers make the market work.

Thank you for your time.

[The complete prepared statement follows:]

STATEMENT ON  
"IMPROVED CREDIT CARD DISCLOSURE REQUIREMENTS"

Alan Fox, Legislative Representative  
Consumer Federation of America

Before the Subcommittee on Financial Institutions  
and Consumer Affairs  
Senate Banking Committee  
Hon. Slade Gorton, Chairman  
May 21, 1986

My name is Alan Fox. I am Legislative Representative for the Consumer Federation of America (CFA). CFA is the nation's largest consumer advocacy organization, with a membership of over 200 national, state and local consumer, rural, labor, cooperative, senior citizen and other groups that together have over 30 million individual members.

CFA strongly endorses legislation such as the three bills under consideration today which will provide consumers the information they need to make informed choices in the credit card market. Under current law, consumers do not receive critical pricing information until after they apply for and receive a credit card. As a result, consumers are unable to seek out the cards which best suit their needs and lack the ability to force credit card issuers to compete. These bills will give consumers the information they need when they can make the best use of that information. The bills impose no significant costs on credit card issuers -- except the costs that come from true competition.

Consumers today simply do not know what they are paying for the use of their credit cards. A Mastercard study of 373 cardholders conducted in 1984 reveals the extent of consumers' lack of awareness about important pricing factors:

- \*27% of the consumers charged an annual fee are unaware they are paying such a fee. Of those who are aware of the fee, 35% knew the correct amount but 38% understated it.
- \*Only 25% of the consumers whose annual fee had been increased knew it; 67% incorrectly stated that there had been no increase.
- \*78% of the consumers whose interest rate had been increased were unaware of that important fact.
- \*Only 17% of those surveyed knew their interest rate, 27% understated it, and more than half simply did not know.
- \*70% of the consumers whose grace period had been eliminated in the previous three years were unaware of that fact. Of all the price components in the study, consumers were described as "least knowledgeable" about the elimination of grace periods.

There are many reasons why consumers are not aware of credit card costs. No legislation can deal with all of those reasons. The goal of each of these bills is to improve consumer awareness at a most important point: When consumers decide whether to apply for a particular card.

I know of no other product or service for which consumers are expected to make purchasing decisions with so little information about costs. Under current law, most cost disclosures are provided only after the consumer has applied for and received a card. Disclosure requirements appear to be more suited to the days when credit card applicants more commonly applied for credit cards only at the bank at which they had other accounts.

Today, credit cards are marketed nationally by mail. These solicitations usually include the amount of the annual fee and the interest rate, but these disclosures are rarely clear or conspicuous. They commonly appear in fine print on the back of the application, an application which is smothered in several pages of glossy four-color hype. Other important terms such as grace periods, late fees and other charges, and the method of calculation of balances on which interest may be paid, are not disclosed.

The information required by each of these bills would not replace the more detailed information contained in the cardholder's agreement mailed with the card itself. Each bill would provide clear, conspicuous and succinct information about the most important elements of credit card costs. That information will allow each consumer to decide which card best meets his or her needs.

There is, however, one important element of credit card pricing which cannot be adequately addressed through improved disclosure. Different balance calculation methods can result in consumer costs varying by greater amounts than large differences in interest rates.

A report prepared for the General Assembly of Virginia by the Colgate Darden Graduate School of Business Administration of the University of Virginia, entitled Credit Card Billing Practices in Virginia, illustrates the large effect balance calculation methods have on costs to consumers. The report notes that:

Neither federal nor state statutes completely define the balance that is subject to finance charges. Consequently, a wide range of options for defining the finance charge balance is open to lenders and sellers.

The report goes on to calculate the costs consumers might bear under four balance methods permitted by Virginia law: Previous balance, average daily balance, ending balance, and adjusted balance. On accounts with identical patterns of activity -- a \$400 previous balance, \$300 payment, and \$50 purchase at 18% during one month -- the finance charge ranged from \$1.50 to \$6 -- a factor of four.

The effect of these different balance calculation methods is far greater than the effect of even relatively large changes in the interest rate. An account using the most expensive method, the previous balance method, would have to have an interest reduced all the way down to 4.3% to result in finance charges as low as the least expensive alternative, the adjusted balance method, and the rate would have to drop to 11.25% to match the costs of the second most expensive alternative. Conversely, an account with an adjusted balance method could bear an interest rate of up to 72% before it would match the costs of the 18% previous balance method account.

Even banks using purportedly identical balance calculation methods may produce vastly different results. The Virginia report describes in detail the "average daily balance" calculation of one bank which results in an "average daily balance" higher than the daily balance in any one day in the billing cycle. How does it arrive at this curious definition of average? The "average" is really the sum of the averages for the previous two months. In the example shown, a customer whose October cycle balance averaged \$383.48 per day and whose November cycle balance averaged \$426.52 per day was charged interest for November on the sum of those two figures, or \$810.00, even though the balance never exceeded \$685.30 on any day of the two-month period.

This particularly interesting interpretation of an "average" is made possible because the bank in question retroactively applies finance charges if payment on a previous balance is not made in full.

Today, a consumer has no way of knowing about this or any other similar practice when he or she applies for a card. Disclosure of this practice in the same manner as the other disclosures required by the bills could be misleading in the extreme if the method were merely identified as an "average daily balance" method, and unreasonably burdensome if a detailed disclosure of the method were required; the description of the method contained in the banks' current disclosure takes over a page of single-spaced print.

Even if problems such as these could be solved, it seems unlikely that the resulting disclosure would allow any consumers to determine which of two or more competing cards would best meet their needs. How many consumers can tell whether a card with an 18% rate on average daily balances is more or less costly than a card with a 21% rate on adjusted daily balances?

The fact is that factors such as different balance calculation methods, which cannot be easily quantified, allow competitors to avoid competing by hiding cost differences in impenetrable thickets of words. If consumers know that paying 18% interest will cost them less than paying 21% interest, they can shop intelligently and fuel competition. If they do not have that assurance, they may as well use a dartboard to select a card. Permitting wide variances in such methods only serves to reward offerors who can figure out novel uses of arithmetic which allow them to collect more money from the same or a lower interest rate than their competitors.

Consequently, we strongly support the provisions of S. 2421 that standardize balance calculation methods in order to provide consumers with consistency in pricing. Eliminating differences in balance calculation methods will force competitors to compete on the basis of easily comparable prices by preventing them from obscuring price differences. If balance calculation methods are eliminated as a difference between cards, price competition must focus on easily understood and compared terms -- interest rates, grace periods, and annual, monthly or per transaction fees.

If balance calculation methods continue to differ, these simple and direct disclosures will not serve their purposes of allowing consumers to shop and of forcing lenders to compete. Failure to standardize this factor would be somewhat like requiring retailers to post prices while allowing them to define weights and measures however they want.

We endorse the requirement that card issuers use an average daily balance method. To eliminate abuses such as the one documented in the Virginia report, the method should be explicitly defined as one in which the sum of the daily balances during the period covered by the statement is divided by the number of days in the period covered by the statement. This definition would not require a grace period, and would allow elimination of a grace period in future purchases if payment is not made in full, but it would prohibit retroactive assessment of finance charges which distort the meaning of "average daily balance."

There are a number of other, relatively minor, differences among the three bills which we have addressed in an appendix to this statement. We commend the subcommittee and the sponsors of these bills for advancing these modest and balanced approaches to credit card pricing. Credit card interest rates are too high. When consumers have access to information about lower cost cards they can reduce their costs and put pressure on the entire market to be more competitive. Improved disclosure can only work to the benefit of both consumers and offerors of credit cards.



## APPENDIX: Significant differences between the bills

## 1. When are disclosures required?

S. 2140 - On or with initial applications  
 S. 2264 - In application or pre-approved card solicitation  
 S. 2421 - Solicitations or ads mailed to consumers  
 Comments: S. 2421 is the most narrowly drawn; it would not apply to applications delivered through methods other than mail. A combination of the other two bills, requiring disclosure on or with an application or a "pre-approved" solicitation, would prevent use of other delivery methods to circumvent the law.

## 2. Disclosure of APR

S. 2140 - APR or, if variable rate is used, method of determining

APR S. 2140 - APR or, if variable rate is used, method of determining

S. 2264 & S. 2421 - APR  
 Comments: The language of S. 2140 should be used. In addition, if a variable rate is used the current rate should be disclosed.

## 3. Disclosure of payment terms and grace period

S. 2140 - Period within which payment must be made to avoid additional charges  
 S. 2264 - Grace period or absence of grace period  
 S. 2421 - Conditions under which finance charge may be imposed, including grace period or absence of grace period  
 Comments: S. 2421 proposes the broadest disclosure and thus should be used.

## 4. Disclosure of annual and other fees

S. 2140 - Annual or other fee imposed for issuance or use  
 S. 2264 - Annual or other fee required to be paid for use of the account  
 S. 2421 - Annual fee and other charges applicable to issuance or use  
 Comments: The intent of all three bills seems to be to cover annual or other periodic fees, per transaction fees, and any other fees, such as statement fees for routine use of the account. Since some issuers routinely impose fees other than annual fees, particularly in states that ban or limit annual fees, this disclosure should be written to clearly encompass all such methods.

## 5. Disclosure of minimum periodic finance charge

S. 2264 - Any minimum or fixed amount imposed as a periodic finance charge  
 S. 2140 and S. 2421 - No provisions  
 Comments: This provision should be included in conjunction with disclosure of the APR, because it may have the effect of increasing the actual rate paid.

## 6. Balance calculation methods

S. 2140 - Disclosure must include statement of how balance is computed  
 S. 2264 - No provision  
 S. 2421 - Average Daily Balance method must be used  
 Comments: We strongly endorse the S. 2421 provisions, as described in detail in the testimony.

7. Reporting to Federal Reserve Board  
 S. 2264 - Issuers must make quarterly reports to FRB of disclosed information  
 S. 2140 and S. 2421 - No provisions  
 Comments: This information will be invaluable both to individual consumers and to researchers. It should be possible for the Fed to develop a very short form for submission, compilation and disclosure of this information.

Senator GORTON. Mr. Holstein.

**STATEMENT OF ELGIE HOLSTEIN, ASSOCIATE DIRECTOR,  
BANKCARD HOLDERS OF AMERICA**

Mr. HOLSTEIN. I know that consumer groups often complain about being the last up to testify, so I think, as Mr. Fox pointed out, we are now learning that when you're the first up to testify you're subject to all the slings and arrows of outrageous banking industry lobbyists who may follow you, but so be it.

I appreciate the opportunity to testify today on behalf of the members of the Bankcard Holders of America. We have 130,000 members distributed throughout the 50 States and we are the only national consumer organization working exclusively on consumer credit card issues.

Since this subcommittee last met on that tragic day of the shuttle disaster in January to consider the issues relating to credit cards, the concerns of the credit card holders and the plight of the 90 million credit card holders in this country have only worsened with respect to interest rates.

Inflation has dropped below 5 percent. The Federal Reserve's discount rate has now dropped to 6.5 percent, and the prime rate is down, yet credit card interest rates remain at astronomical levels in excess of 18.5 percent.

**INTEREST RATE OF 19.4 PERCENT FOR 25 LARGEST ISSUERS**

The 25 largest issuers of credit cards, which interestingly enough enjoy the greatest economies of scale in terms of their administrative costs, are charging actually more than that 18.9 percent average. They are charging an average of 19.4 percent.

The high administrative costs that the banks allude to, are offset by a rapidly increasing number of other fees, not just the once-uncommon but now common annual fees, but over-the-limit fees, transaction charges, late fees, shortened or eliminated grace periods and so forth, all of which go to cover these administrative costs.

It's difficult to reach any conclusion other than that the banks are still refusing to compete on the basis of interest rates. Instead, they are choosing to restrict their so-called competition to a variety of travel and entertainment frills to lure consumers in, and then they hit them with very high interest rates.

This uninformative advertising directed at prospective card holders I think virtually guarantees that consumers will not be able to make educated choices among cards, particularly when you look at the tremendously detailed and varied ways in which these credit card charges are arrived at on a monthly basis.

This is a disclosure statement that accompanied a card holder agreement and it goes on at great length, but with greatly confusing detail I might add, in an attempt supposedly to comply to the letter with the Federal regulations. And yet I think there are many elements of card charges that remain a mystery even after you've gone over this type of statement with a microscope.



## GRACE PERIOD IS A CONFUSING ITEM

The grace period stands out as a particularly confusing item for most card holders. There have been a couple of States that have required a grace period to be offered, but in most places in the country consumers are faced with a "now you see it, now you don't" type of arrangement. Most of them are totally unaware that if they have carried over a balance from the previous month they forfeit the grace period. If you add to that grace period the variations, the differences that Mr. Fox alluded to in assessing monthly finance charges and the new range of administrative fees mentioned earlier, I think the result is a confused public stuck with high costs and no information.

As we stated earlier this year in testimony submitted to this subcommittee, we do favor limits on credit card interest rates, but I think that the legislation before the subcommittee today does represent an important first step.

We have actively participated in State legislative hearings across the country, so far appearing in front of 9 State legislatures, providing assistance to a total of about 15 States. And the question continually comes up about what Congress is going to do. Some of these States are considering legislation similar to that before you today to require disclosure. I brought with me for submission in the record a summary some of the State bills that are under consideration or indeed one that's recently been passed in the State of Wisconsin.

[Copy of State legislation similar to proposed congressional legislation follows:]



HOLDERS OF AMERICA

333 PENNSYLVANIA AVE., S.E., WASHINGTON, D.C. 20003, 202/543-5805

A non-profit consumers association dedicated to protecting the interests of bank card holders

## STATE LEGISLATION

## Disclosure Issue

WISCONSIN

ACT 244 effective date 1/1/87 With regard to every open-ended credit plan:  
included in every application as well as those within advertisements  
the following should be stated:

- (1) annual percentage rate varied or fixed
- (2) date upon which finance charges begin to accrue
- (3) whether annual fees are charged and the amount of the fee
- (4) whether any other charges or fees may be charged

Date of enactment: April 15, 1986

New York

Bill being introduced by Assemblywoman Jacobs

Within a New York State application it must be clearly stated:

- (1) annual percentage rates
- (2) periodic finance charges
- (3) grace periods

California

AB 3333 introduced by Assemblyman Areias, out of committee and to be brought to the floor of the Assembly late next week.

At the point of solicitation; on applications as well as those in advertisements in easy to read tabular form the following:

- (1) interest rates fixed or variable
- (2) transaction fees
- (3) grace periods
- (4) cash advance fees

Mr. HOLSTEIN. The legislation you have before you today would not represent any sort of major intrusion into the free market of credit cards. In fact, we think that it would be a major boost to competition. By definition, a competitive market requires information and that's what's missing in the credit card market today.

This is an ad for an auto loan and you can see the largest type in this ad is the interest rate printed in huge black letters in the center. This is a two-page ad for a credit card loan and if you look in the tiny print—I have to remove my glasses to see it—it says,

I understand that if I use the card or authorize its use or do not cancel my account within 30 days after I receive the card, the agreement sent to me with it will be binding on me and I will be responsible for all applicable fees.

This, of course, means that card holders do not learn what the charges are going to be until after they receive their cards. Then if they decide they don't like the charges, unless they take affirmative action within 30 days to reject their card, they are automatically liable for the annual fee even if they have thrown the card into a drawer somewhere refusing to use it.

The proposals before you today, I think, are important in several respects and I'd like to mention a couple of specific items.

First, of course, the disclosure requirements are excellent and I think are long overdue. If there's any way to encourage a simple explanation, perhaps even with examples in the initial card holder agreement that's sent, I think that would be very useful.

The provision in your bill, Mr. Chairman, to require the use of the average daily balance or a cheaper method, I think, would provide some welcome uniformity, but I think that same concept of uniformity should be extended to the grace period. I see no reason why consumers should continue to be faced with this "now you see it, now you don't" arrangement under which they sometimes get a grace period and at other times don't get a grace period.

#### FED DATA

Next, with respect to Senator D'Amato's bill, I think it's excellent to have the Federal Reserve collect this information and I was incredulous in listening to the witnesses from the Federal Reserve, that collects so much data, and the industry which submits so much data, saying that they would find it administratively difficult to compile this information and stick it on a library shelf.

But, Senator D'Amato, I think I would suggest that the bill should be taken one step farther, especially after listening to the Federal Reserve Board's testimony immediately preceding. I think the Federal Reserve should not only be required to collect this information, but should be called upon to disseminate it through existing channels of consumer information at the ready disposal of the Federal Government—the Consumer Information Center, the Federal Trade Commission, the existing networks that go out between Federal agencies and State and local consumer information offices and consumer protection offices, perhaps Social Security offices and post offices. These are regular, established channels to get information out to the American public. This approach could even be tried on a limited basis so that you would not have to make it a permanent requirement of law. It would just be tried for a period

of time to try to get some of this information out and hopefully restore some active competition to the marketplace.

Finally, I think the annual report to Congress is an excellent idea on all of these matters because the subcommittee's review of these issues I think should be ongoing. We certainly appreciate the scrutiny you've lent to this issue thus far.

I want to stop there because I know there are other witnesses and a crowded schedule today and I thank you for the opportunity to testify.

[The complete prepared statement follows:]



# HOLDERS OF AMERICA

333 PENNSYLVANIA AVE. 1E. WASHINGTON, D.C. 20001 202-540-5825

A non-profit consumer organization dedicated to protecting the interests of bank card holders.

## TESTIMONY OF ELAINE HOLSTEIN ASSOCIATE DIRECTOR BANKCARD HOLDERS OF AMERICA BEFORE THE SENATE SUBCOMMITTEE OF FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS MAY 21, 1986

I am pleased to provide testimony to the Subcommittee today on behalf of the members of Bankcard Holders of America (BHA). BHA is a national, non-profit consumer organization dedicated to informing its members and the public about the rights and responsibilities of credit card users. BHA is the only national consumer organization working exclusively on credit card issues and has been participating actively in providing information to state legislative and Congressional committees reviewing credit card issues.

Since this subcommittee last met to consider credit card issues, the news for the nation's 91 million credit card consumers has only gotten worse. As interest rates throughout the economy have continued to fall, credit card interest rates have remained stubbornly high. Currently credit card interest rates average 18.9%. The twenty-five largest issuers of credit cards, which incidentally, enjoy the greatest economies of scale in their card operations are charging even higher rates: 19.1% on average. Meanwhile the banks own costs of money have fallen to approximately 7%. The Federal Reserve's discount rate, a reliable indicator of the direction of the cost of funds in the economy, has now fallen to 6.5%.

While the banks claim that high administrative costs require them to continue charging astronomical rates, they continue to add new administrative charges on top of the interest they collect: late fees, over-the-limit fees, transaction charges, and shortened or eliminated grace periods, in addition to the non-common annual fees. If the high interest charges are necessary to cover the banks' administrative costs, we wonder why they also need all the new, additional fees?

It is difficult to escape the conclusion that the banks are simply refusing to compete with one another on the basis of credit card interest rates. Instead, they continue to restrict their "competition" to travel and entertainment firms instead of offering fair interest rates. Thus, credit card advertisements and direct-mail solicitations emphasize "rewards" such as health club memberships, travel services, and book-of-the-month clubs. In fact, such advertising often

contains no reference whatsoever to the terms and conditions of the cards.

The uninformative advertising directed at prospective cardholders, and the complicated formulas used to concoct monthly credit card charges on existing cards, virtually guarantee that consumers will not be able to make informed choices among cards. In turn, this ongoing consumer confusion makes it possible for the banks to camouflage the high cost of credit cards.

The grace period stands out as a particularly confusing item for most cardholders. Except where prohibited by state law, conventional banking practice is to deny the grace period on current-month purchases to consumers who have carried over any unpaid balance from the previous month. Thus, consumers are faced with a "now-you-see-it, now-you-don't" approach to credit card grace periods. The problem has worsened as more and more banks take steps to shorten or eliminate the grace period, regardless of whether or not the cardholder has carried over a zero balance from the previous month.

Add to grace period variation the differences in balance calculation methods and the range of new administrative fees mentioned earlier, and consumers are stuck with high costs and no information.

As we have stated in testimony submitted earlier this year to this subcommittee, we favor legislation to limit credit card interest rates. Previously, of course, this vital consumer protection function was performed by the states. In this new world of interstate banking, however, there is a growing need for a uniform approach to high credit card interest rates.

Most states provided this protection to consumers until several years ago, when the banks, faced with double-digit costs of money, began threatening to move operations to states with more favorable regulatory environments. Some thirty-four states responded by raising or eliminating their ceilings on credit card interest rates. In today's low interest rate environment with a few exceptions, consumers are receiving no meaningful protection from their state governments.

The legislation you have under consideration today would be a critical first step in restoring protection to the country's credit card holders. Rather than being an intrusion into the free market, as representatives of the banking industry claim, we believe that it would provide a much-needed boost to competition by giving consumers the information they need to make informed choices in the marketplace.

In fact, by definition, a competitive market requires information. Often, consumers do not learn of the interest rates and other terms and conditions of the cards for which they apply until after they receive them. At that point, the consumer is deemed to have accepted the card unless positive action is taken within thirty days by the consumer to reject the card. Thus, even if the consumer decides after receiving the card that the interest rate or other terms are unacceptable, and chooses not to use the card, an annual fee will be levied unless the

consumer acts quickly to reject it.

The banking industry assures us that all terms and conditions of the cards are clearly disclosed in the "Explanation of Finance Charges" that accompanies consumers' monthly statements. Such assurances are laughable, however, to anyone who has ever tried to verify their bill by attempting the mathematical gymnastics outlined in tiny print on the back. By comparison, IRS forms read like Dick and Jane primers.

The proposals before you today, while they would not deal directly with the continuing problem of high interest rates, would nevertheless provide important consumer benefits. Several specific points are worth noting.

1. The provisions in the various bills requiring disclosure of all the terms and conditions of credit cards in all card advertising is critical if consumers are to have the basic tools for making comparisons among cards. If there is any way to encourage simple explanations, perhaps with examples, in the explanations of terms and conditions provided to cardholders, that would be a helpful additional consumer protection.
2. The provision in Chairman Gorton's bill, S. 2421, to require the use of the average daily balance, or cheaper, method in calculating monthly interest charges on bank cards would be a welcome move toward both uniformity and cost protection for consumers.
3. The provisions in Senator D'Amato's bill, S. 2264, requiring the submission by card issuers to the Federal Reserve of the various terms and conditions of their cards is of enormous potential help to the millions of consumers who would like to find better deals on their credit cards, but who just do not know where to find them. To make this reporting system worthwhile, the Federal Reserve should be directed to release this information periodically through existing consumer information channels. These might include the National Consumer Information Center, the Federal Trade Commission, the White House Office of Consumer Affairs, perhaps post offices and social security offices, as well as the various networks of state, local, and private consumer information offices. This approach to active dissemination of important money-saving information could be tried on a test basis for a specified period of time and need not be continued as aggressively if the banking industry begins to respond with more competitive behavior in the marketing of credit cards.
4. An annual report to Congress by the Federal Reserve on the credit card issues that have been reviewed by this Subcommittee will ensure that any modifications in reporting requirements necessary to protect consumers or banks could be undertaken promptly.

Bankcard Holders of America welcomes the Subcommittee's continued interest in the need for consumer protection on the subject of credit cards. We appreciate the opportunity to present our views on these issues, and we look forward to continuing our work with you on them.



## PREEMPTION OF STATE DISCLOSURE LAWS

Senator GORTON. Do the two of you believe that these bills should preempt State disclosure laws with respect to solicitations only, not to contracts but to solicitations only, in order to make it easier to comply with these proposals if they become law?

Mr. Fox. I think we now have a national market for credit cards and certainly the solicitations that go out in the mail are sent out nationally. I was looking at the return addresses on these and they are Maryland, South Dakota, and Delaware. I'm not sure that the States have much ability to regulate the mail that comes in from out of State.

So if we're going to have consistency and allow people to compare all solicitations they get, I'm afraid there probably would have to be that sort of Federal preemption and to the extent that there is any burden of compliance on the credit card offerers that would certainly reduce any such burden.

Senator GORTON. Mr. Holstein.

Mr. HOLSTEIN. I'm not sure that I agree with Mr. Fox. He and I haven't discussed this. But my feeling is that perhaps the Federal requirements ought to be minimum requirements. In fact, the States already do regulate a variety of different types of solicitations for major industries—sweepstakes offerings, insurance offerings of every kind are subject to a wide variety of different State regulations and it doesn't seem to slow down those industries in the least.

I think perhaps there could be minimum requirements and my feeling is that the vast majority of States would be happy with Federal minimum standards, but I don't think that I would go so far as preemption.

In fact, I would even suggest that the current prohibition against States imposing credit card interest-rate limitations on out-of-State banks should be modified so that a State could protect its citizens from credit cards being marketed in the State but originating from out-of-State banks. I really would urge this subcommittee to take a look at that.

You know, historically, this has been an area of State concern. Prior to 1979, 48 of our 50 States regulated credit-card interest rates, but the banks incurred legitimate problems with the high money costs and 34 States raised their ceilings or threw them out entirely. Now, as Alan points out, with interstate banking, this really is a new world and the States are finding it difficult to provide meaningful protection.

Senator GORTON. I will submit the rest of my questions to you in writing.

Senator D'Amato.

Senator D'AMATO. Mr. Chairman, I want to commend our two witnesses today for being so succinct in their testimony, particularly as it relates to the issue of the average daily balance. Mr. Fox, I think you've done an outstanding job.

I want to commend our chairman for raising this issue as he points out the problem in his bill and I will be supportive of that, Mr. Chairman, because as Mr. Fox indicated, all things being equal, you have decidedly different results in the manner in which

you undertake those computations on the balances and so if you tell one person they have 12.5-percent interest and the grace period is the same but you have a far different method of computing the balance, you throw those figures out dramatically. That's why these hearings are so important and I want to commend the chairman again for holding it and for his work in this area to bring this to a head.

I think we're going to have a battle on this, but I think we are going to win this battle and I share Mr. Holstein's observations that it's absolutely ludicrous for someone to say that the Federal Reserve—it would be too great a burden for them to collect this information or on the bank to send it twice a year and then publish this with the Congress and then again the various consumer groups, I think, could pick up that information.

One of the reasons we held down on the reporting was simply to deal with the contention that this would be a great deal of paperwork and, therefore, that the Federal Reserve should compile this information, make it available to the Congress, and obviously then that information could be disseminated to the various consumer groups, and we did that specifically so we wouldn't have the Federal Reserve or others saying, "Oh, what a terrible burden this would place," and yet we still hear them raise that cry and I reject that as being at variance with the facts.

Thank you, Mr. Chairman.

Senator GORTON. It took us some time to hear from you but we're very happy that we were able to do so.

Senator Dodd is here. Do you have any comments or questions of these witnesses?

Senator DODD. I have a statement, Mr. Chairman.

Senator GORTON. Without objection.

#### OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Mr. Chairman, thank you very much for holding these hearings on the various bills—including yours and mine—that seek to address the problem of inadequate and untimely disclosure of information to purchasers of credit cards.

At the last hearing on the general subject of credit card interest rates and proposals to place caps on them, we experienced a bit of role reversal, with Republican Senators Hawkins and D'Amato arguing for interest rate caps and Senators Proxmire and myself raising questions about the legitimacy of such an approach and suggesting that disclosure might be the preferable alternative.

Since then, Chairman Gorton, you and I as well as Senator D'Amato have all introduced bills designed to give consumers information about annual fees, the annual percentage rate and any grace period before interest charges would be incurred at the time of solicitation. Under present law, such disclosures are made when the customer gets the card, but that really is too late to make an informed decision; consumers need the information earlier so they can shop around, if they are so inclined.

I think these are needed reforms. In fact, I think these disclosures should be made—probably in a box setoff from other information—both at the time of solicitation as well as the time of receipt

of the cards. The latter disclosures, required by the Truth in Lending Act today, are not intelligible to the average human being or, for that matter, to the average Ph.D. in economics.

The more difficult question relates to whether we can or should require a standardized balance calculation. It is clear that an APR does not reveal a true comparison between card issuers when they use different bases for calculating the balance. On the other hand, I am not sure if it is possible to mandate a specific balance calculation method, given that the particular circumstances surrounding the timing of acquisitions and payments by a card user makes some balance calculation methods favorable to one user and unfavorable to another.

I am hopeful that this hearing will shed light on this difficult task as well as develop a consensus on the basic disclosure approach.

#### DISCLOSURE AT TIME OF RECEIPT OF CARD

Let me just ask if I can, there are various proposals kicking around on what makes sense. The bill that I have in would be just a notification, as you know, during the solicitation period of what the various elements would be, those that under the Truth in Lending Act are received at the time the card is actually received.

As I've looked at it, the truth in lending language seems to me to be extremely difficult to understand and almost useless unless you're someone that actually homes in on this thing and it might make some sense to have some plain English disclosures at the time of the actual receipt of the card as well as at the time of the solicitation.

I wonder if you might comment on that?

Mr. Fox. I haven't really considered that idea. I guess I would view the disclosure, the so-called card holder's agreement that arrives with the card itself, as probably most useful as a piece of reference for the consumer so that if something comes up or if they want to know something they can go back and look for it. I don't think anybody uses that when the card arrives and goes through it and memorizes the details.

What is proposed by all the legislation is to take the sort of plain English simple cost comparison information and put that at the point where the decision is made about which card to accept. Perhaps there may be some benefits to taking other basic information that's not cost-related that would not be made available at that time and making that clearer.

At the present time, I suspect most consumers might dig out the agreement if something came up and tried to find the answer to their question.

Senator Dodd. At which point they would probably find out it's a little too late to do much anyway.

Mr. Fox. Well, it may or may not be. If they have a complaint about a billing problem, that's where they would find the information on how to complain about the problem or try to get the problem resolved and that sort of information. I doubt that anyone would think would be very important at the time they get a card,

but they would want to know that it's available in detail when the time came to use it.

Mr. HOLSTEIN. Senator, a brief survey was done by a local television station here in Washington about 2 months ago in banks, going around to bank tellers asking them about the ways in which the grace period is calculated and they discovered that the vast majority, over 75 percent—this is obviously not a scientific poll—but over 75 percent of the people they interviewed could not explain or did not know the differences in circumstances under which a grace period is awarded and under which it is not.

The statements of terms and conditions that accompany these cards frequently are so detailed in their language that it is impossible to ascertain those things for anybody other than perhaps a CPA. I do address that in my written testimony and do call for simple language and it seems to me that if the IRS and insurance companies and the Census Bureau and some of the other great institutions in our society today can find ways to write their various forms and so forth in plain language, I don't see why the banking industry couldn't be relied upon for the same sort of effort.

Senator DODD. And you would include it both obviously at solicitation but also at the time the card is actually delivered to a person?

Mr. HOLSTEIN. I certainly think so because it's that statement that arrives with the card that is kept with the card holder's permanent records, or at least should be kept for further reference, but most of them are so detailed that they are very difficult to understand.

Senator DODD. I thank you both very much. Thank you, Mr. Chairman.

Senator GORTON. Thank you both very, very much.

Messrs. Craft, Rohner, Ms. Fernstrom, and Mr. Feldman. We will start with Mr. Craft and, again, at 5 minutes each we're only going to have a chance for a couple of questions, so please try to limit your statement to the greatest extent possible. Your full written statement will be included in the record.



At the end of 1984, over 69 million Americans held one or more bank cards (1.9 cards on average) and over 59 million card accounts were active monthly. The card has been marketed responsibly, and has been embraced by a public that values highly its ongoing service features. Additionally, the cardholder is protected by a combination of state and federal laws, including Truth-in-Lending and the Fair Credit Billing Act.

In sum Mr. Chairman, we are discussing today a product that the consumer appreciates in large numbers. There is no cry across the land from card users for altering the presentation and marketing of the bank card. We must move with care in making changes to a successful and responsible way of doing business.

The bills (S.2140, S. 2264, and S.2421) introduced by Senators Dodd, D'Amato, and the Chairman share many similarities in the terms required for disclosure, and the types of materials to be covered. However, they also contain significant differences in covering the distribution of solicitation materials and approaching the computation of finance charges.

In the interest of presentation simplicity, we have constructed a chart which summarizes, for ease of comparison, the key provisions of the three bills. We hope this chart represents fairly the substance of the bills.

The purpose of these bills is well-intentioned: to enable customers to make an informed choice in the selection of a credit card. The Association supports this goal. We believe this is reflected in the industry's general practice toward distribution of promotional mailings.

Mr. Chairman, we would first like to note that there is already adequate disclosure of pertinent information regarding credit cards under Truth-in-Lending. As required by Section 127 of that statute, creditors

STATEMENT OF JERRY D. CRAFT, SENIOR VICE PRESIDENT,  
FIRST NATIONAL BANK OF ATLANTA AND CHAIRMAN OF  
THE RETAIL ELECTRONIC SERVICES AND BANK CARD  
DIVISION, AMERICAN BANKERS ASSOCIATION

Mr. Chairman, members of the Subcommittee, I am Jerry D. Craft. I am Senior Vice President of The First National Bank of Atlanta and also acting Chairman of the Retail Electronic Services and Bank Card Division of the American Bankers Association. In that latter capacity, I am presenting the views of the Association on proposed legislation regarding disclosures for credit card solicitations, applications, and advertisements. The Association appreciates the opportunity to discuss credit card disclosures with the Subcommittee.

One of the premier success stories in the history of financial services is the growth and use of the bank card by the American public. In the short period of twenty years, the card has been developed and marketed through tremendous efforts and the dedication of huge resources by the banking industry.

The card is a multi-purpose service product that combines the advantages of open-end credit, identification, payments transactions, and ease of repayment. The credit card over the past two decades has come to represent for consumers a safe, secure, convenient means of payment and credit access that is accepted almost universally. It has many features that contribute to its value, over and above its function as a means of access to a line of credit.

PROPOSED SENATE LEGISLATION  
ON CREDIT CARD DISCLOSURES

SUMMARY OF PROVISIONS

|                                             | <u>FOOT<br/>S. 2140</u>                       | <u>GORTON<br/>S. 2421</u>                                                                                                                 | <u>D'AMATO<br/>S. 2264</u>                                                                                                                                  |
|---------------------------------------------|-----------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|
| AMENDS                                      | Section 127 - TIL                             | Section 127 - TIL                                                                                                                         | Section 127 - TIL                                                                                                                                           |
| COVERAGE                                    | Initial application or accompanying materials | Solicitations or advertisements mailed to consumer                                                                                        | Applications or solicitations to open account                                                                                                               |
| DISCLOSURES:                                |                                               |                                                                                                                                           |                                                                                                                                                             |
| -- Rate                                     | APR, or basis for determining variable        | APR                                                                                                                                       | APR                                                                                                                                                         |
| -- Fees                                     | Annual or other fee for issuance or use       | Annual, and other charges applicable to issuance or use                                                                                   | Annual or other charge for use of card. Any minimum or fixed amount imposed as monthly or periodic finance charge                                           |
| -- Grace period                             | Date for payment to use grace period          | Explanation of grace period or disclosure there is none                                                                                   | Explanation of grace period or disclosure there is none                                                                                                     |
| OTHER:                                      |                                               |                                                                                                                                           |                                                                                                                                                             |
| -- Balance on which finance charges imposed | Disclose how determined                       | Mandates average daily balance method or alternative with lower finance charge.<br>-- Board prescribes criteria for average daily balance | Card issuer will submit quarterly to Board on the above disclosures. Board will make information available to public upon request and to Congress annually. |
| -- Reporting Requirements                   | --                                            | --                                                                                                                                        | --                                                                                                                                                          |



Throughout this discussion, we should make a distinction --- on the one hand --- between providing sufficient information in a promotional mailing for a potential customer to make a choice and --- on the other hand --- numbing the customer's comprehension with a bewildering, and often discouraging, legal brief of disclosures.

For example, the requirement to disclose "annual fees and other charges" raises the spectre of listing charges for abusive and abnormal use of the card product: late payments, bad checks, card replacements, overlimits. These exceptional handling charges should not be included in the promotional mailing.

The promotional mailing should contain pricing information for the normal use of the product, like annual fees and transaction charges, if any. Consumers do not anticipate that they will habitually pay their bills late, so a late payment charge is not a critical element in choosing the card. Rather, consumers look to features which will be applied consistently to the account --- that is, annual fee, transaction fee, APR. Phrasing such as "annual or other charge or fee imposed for the issuance and normal use of the credit card" is suggested to encompass all unavoidable and recurring charges without cluttering the disclosure.

The "grace period" disclosure is common to the three bills under discussion today. Although we do not oppose disclosing the availability of a grace period, we have concerns about translating a simple concept into a cumbersome explanation.

Once again, any new disclosure should be limited to salient features and should avoid complicated, lengthy explanations that may hinder what is otherwise a compendious disclosure of pertinent features. A simple statement disclosing the availability of the grace period, or lack of it,

must provide the consumer with a comprehensive and detailed range of information. Specifically, creditors must provide a statement of when finance charges start to accrue, the APR, an explanation of the method used to determine the balance on which a finance charge may be imposed, the method of determining the amount of the finance charge, identification of other charges, and other information relating to security interests and billing rights.

This information must be received before the first transaction is made. Ordinarily, this means that --- at the latest --- the disclosures must be received by the time the card is received. Thus, consumers may still decide to keep or reject the card, based on evaluation of information available when they receive the card. In addition, a complete range of disclosures is provided to the customer with each statement.

Nevertheless, the ASA supports reasonable efforts to enable consumers to make intelligent choices --- in a very competitive market --- if it is determined that additional disclosure is necessary. We would emphasize, however, that any new disclosure should be meaningful, understandable, and useful for the purpose of choosing a card. In this regard, we believe that disclosure of the APR, any annual fee, and the availability of a grace period are the crucial features influencing a consumer's choice of credit card. Disclosures therefore should be limited to these elements.

The simpler the disclosure, the more likely that it will be useful to the consumer. In addition, any disclosure requirements should be limited to mailed solicitations and should exclude the broader area of advertisements.

disclosure defeats valid efforts to provide meaningful and useful information to the potential customer.

Consumers do not choose a card based on how the card issuer calculates the balance on which the finance charge is assessed. Instead, they decide based on features that are more readily understandable and that have a more significant impact on their costs — such as the APR, annual fee, and whether a grace period is available. Explanation of this balance computation is complex and long and is, predictably, not easily understood.

Further, comparison shopping among balance computations would rarely be a meaningful exercise for the consumer. Such information is later disclosed as required by Truth-in-Lending prior to the use of the card. It would seem pointless to require disclosure of an item that does not influence the decision process, but — because of length and complexity — may in fact dilute the effect of other more salient disclosures. Moreover, the consumer will receive the information in a timely fashion anyhow.

Finally, the method of calculation of the balance — particularly among the various average daily balance methods which are commonly used by banks — makes little difference to the total amount of the finance charge.

Generally, banks employ some variation of average daily balance system when determining how the finance charge will be assessed. The resulting average daily balance is determined by dividing the sum of the daily balances of a billing period by the number of days in that billing period. Variations occur depending on how the daily balance is calculated.

should be sufficient for a promotional mailing. The complexities of how the grace period works can be found in the subsequent Truth-in-Lending disclosures issued before the card is used, and in every statement mailing.

Any legislation aimed at requiring additional disclosures during the promotional period should be limited to solicitations mailed directly to a consumer by the card issuer. This mailed solicitation should contain applications to open a credit card account, or an offer to open an account. Advertisements should be excluded, as well as applications or other written promotional material (for example, "take-ones") available generally to the public at retail outlets, airlines, offices, etc.

Additional disclosures on these kinds of applications and literature would require that each time any term of the disclosure changed, the issuer would have to revise and then reprint all forms. All outdated applications would have to be removed and new ones distributed. Because of the tremendous logistical burdens and costs of changing terms of the credit card account, banks would be less inclined to alter these terms.

In many instances, banks must comply with the rules of various state jurisdictions each time they modify the terms of a credit card account. Imposing a new layer of disclosure on promotional literature would in effect make the terms more rigid and reduce the flexibility of issuers to respond to market pressures — perhaps favorably to the consumer.

Next, Mr. Chairman, we would like to address provisions in the bills that relate to the computation of the balance on which the finance charge is determined.

Senator Dodd's bill (S.2140) requires creditors to disclose — in addition to the APR, annual fee, and length of grace period — a statement of how the finance charge is determined. We are convinced that such a

For instance, some creditors using one method will exclude unpaid previous finance charges from the daily balance. Thus, if no payment is received, the finance charge from that bill is carried forward, but no finance charge is assessed against it.

Some creditors exclude from the daily balance any debits from purchases made during the month, while others include them. Variations may also occur depending on whether payments are applied to principal before finance charges, the opposite, or in equal proportion.

In general, however, these variations produce little difference in the final average daily balance on which the finance charge is imposed. The Association recently computed interest charges based on several variations of the average daily balance method, using an opening balance of \$900. The maximum difference in the monthly interest charge was 24 cents.

A Report to the Governor and General Assembly of Virginia on the credit card billing practices in Virginia supports this conclusion. Table C.3, page C-16 shows that three banks using the average daily balance achieve very similar results when calculating average daily balances based on one account scenario: \$426.52, \$437.96, and \$424.03. The resulting difference in the monthly interest charge, assuming an 18% APR, would be 3 cents.

Thus, at least for banks using the average daily balance method, the method chosen has little impact on the total finance charge. To then include in salient disclosures an extended explanation of a complicated feature that has very limited impact on costs is contrary to the purposes of the disclosure. It does not aid a consumer in comparing credit cards. We believe that this item is unnecessary for these reasons and should not be part of any disclosure.

S.2421 would require creditors to use an average daily balance method (or alternative method resulting in smaller finance charges). The Federal Reserve Board is directed to prescribe criteria under which a balance calculation may be deemed an average daily balance method.

This provision is an unnecessary incursion into a detailed level of product design. Congress should not involve itself in formulas which are part of the infrastructure of a highly competitive market. Again, this invasion of free-market product design has no bearing on legislative intent to assure adequate information for comparison credit shopping.

Also, the apparent exemption for creditors who are also "providers of goods or services" has no basis in logic or fairness. If this provision were helpful to the public, and we believe it not to be, then it should apply equally to all creditors.

Finally, we would like to include a statement for the record on recent legislative proposals to impose interest rate controls on credit cards. We recognize that this issue is beyond the specific focus of these hearings on disclosure. However, we have great concern that the issues are linked in the minds of some legislators. For that reason we wish to state concisely the industry position on credit card rate controls.

1. The supply of credit card credit is intensely competitive. Thousands of banks, credit unions, savings-and-loan associations, retailers, and gasoline companies supply credit cards. Many of them issue cards on a nationwide basis. Even the largest card issuers, such as Sears and Citicorp, have only a small share of the credit card credit market. In addition, other kinds of consumer credit are effectively competitive with

4. Following the recent wave of state deregulation of credit card interest rates, cards issued from control-free states have been much more successful with consumers than cards from states with interest rate ceilings. Since 1980, the national share of bank card credit issued from states without rate ceilings has increased over 13 percent. At the same time, the share of credit from states that still impose rate ceilings had fallen over 17 percent.

Bank card credit from states with "strict" rate controls has fared worse with consumers than credit from states with "moderate" controls. Bank card credit from states with strict "floating" ceilings (similar to those in the proposed national controls) has done worst of all.

This market evidence refutes the argument that consumers benefit from interest rate ceilings. Consumers already may choose between cards with and without rate ceilings -- and they are choosing unregulated cards in rapidly growing numbers.

5. A national interest rate ceiling would lead to a contraction in the supply of credit card credit. This would deflect many consumers to more costly or less convenient forms of borrowing, and would reduce competition in the supply of consumer credit. The economic effects of a national rate ceiling would be similar to, but more damaging than, those already observed in states with strict ceilings on credit card rates.

Card issuers would "reprice" their services to some extent -- for example, by raising annual fees or increasing charges for late payments and account inquiries -- but the opportunities for repricing appear to be limited. Issuers would then be forced to allocate credit by non-price means -- such as by tightening credit standards and restricting cards to local markets and regular customers -- in an effort to reduce their costs

credit card credit. Market concentration in the supply of credit card lending alone is far below what would be necessary for interest rates to exceed costs of supply.

2. Credit card credit has been growing rapidly. Since 1980, balances on bank card accounts have grown nearly 30 percent per account in real terms, and the number of accounts has grown over 40 percent. These rates far exceed the growth in consumer spending and in the over-20 population. Credit card interest rates (and related prices) have remained relatively stable during this period, so the growth in credit balances and accounts indicates a substantial increase in demand for credit card services.

3. The level and stability of credit card interest rates does not indicate excessive pricing or justify rate controls. Most of the costs of supplying credit card credit are administrative costs, not costs of funds to card issuers. While costs of funds in commercial money markets have declined in recent years, the demand for credit card services has increased. The general response has been an expansion and improvement in credit card services rather than a reduction in interest rates: card issuers have greatly increased their credit lines per account, have offered a wider array of card features, and have offered credit to new (riskier and therefore costlier) groups of consumers who previously could not obtain credit cards.

Recently, some major card issuers have reduced their interest rates substantially, but it is too soon to tell whether rates will decline in general. This will depend on future trends in the costs of supply and level of demand for credit card credit.

to the prices permitted by the rate ceiling. Other consumers would substitute other forms of credit which would be more costly than credit card credit (loans from finance companies or local retailers) or less convenient (such as increasing loans on automobiles or houses and carrying larger cash balances).

Mr. Chairman, thank you for letting me present the views of the American Bankers Association on this proposed legislation. I would be glad to answer any questions you may have.



Senator GORTON. Thank you, Mr. Craft.  
Mr. Rohner.

**STATEMENT OF RALPH ROHNER, PROFESSOR, CATHOLIC UNIVERSITY, REPRESENTING CONSUMER BANKERS ASSOCIATION**

Mr. ROHNER. Thank you, Mr. Chairman. I appear this morning on behalf of the Consumer Bankers Association [CBA] and the VISA and MasterCard Associations, both of whom are members of CBA.

Absolutely wishing to maintain the subcommittee's good will, I will be as brief as I possibly can.

**CBA OPPOSES PRESENT BILLS**

CBA has tried in the past to maintain a proactive approach to consumer issues and yet at this point we feel compelled to stand in opposition to the bills pending before the subcommittee.

We believe, both with respect to disclosure of information in solicitations and the attempts to standardize balance computation methods that the proposals are unnecessary at this time, unlikely to achieve in any measurable fashion their stated goals, are likely, especially with the balance computation formula, to impose some significant industry costs which inevitably are passed on to the consuming public, and that the proposals risk some inherent unfairness to financial institutions by discriminating against them and in favor of other suppliers of financial services.

If I could summarize in the briefest possible way, Mr. Chairman and Senator D'Amato, the proposals embodied in these bills are hardly new matters and are hardly items that ought to be considered in a vacuum. They come up out of a history of extensive detailed regulation of credit disclosures under the Truth in Lending Act which has been recently reviewed in this committee and in the Congress in the form of the truth in lending simplification proposals. There are even earlier efforts on the books to reduce, control, and modulate the flow of information to consumers both for their benefit and for that of the industry of suppliers.

There is emerging data about the effect of various disclosure techniques, formats, and items of information on actual consumer awareness. There are Fed studies both of the past and ongoing ones that Governor Rice alluded to. At the very least, it seems to us, Mr. Chairman, that it would be prudent for the subcommittee to wait to gather the greatest possible empirical base before tinkering further with a regulatory structure that's been carefully crafted over time.

If legislation goes forward, we have a number of suggestions about the actual content of any bill. They are reflected in our more extensive statement and we would be happy to answer questions about them or discuss them further with your staff.

**DISCLOSURES SHOULD BE NARROWLY FOCUSED**

I think it is critical, though, that as you yourself suggested any solicitation disclosures be narrowly focused, in terms of what kind of solicitations are covered so as not to spill over unintentionally and destroy structures of general advertising, television and radio

advertising, and the like. They should focus on the items of information that are most critical to consumers at a shopping stage, those, in other words, that will inevitably affect the cost to consumers and not linger over or attempt to delineate in great detail transaction terms that may only occasionally or indeed never be applicable to consumers.

Although this is not reflected in the current bills before this subcommittee, we are concerned about attempts to single out the banking industry for certain disclosure responsibilities that are not shared by others. Those are simply unfair and counterproductive to any goal in fact to educate consumers. Special compliance problems don't need to be treated in exemption fashion, but with some careful thought about flexibility.

With respect to the standardization of balance computation methods, Mr. Chairman, our feelings are even stronger. We suggest that that proposal is not only unnecessary and unwise, but probably undoable and, if doable, only at immense cost to the industry in terms of conversions and the like; also at the cost of immense intrusions on existing State legislation, State regulatory structures with respect to rates. As is pointed out in several of the testimonies this morning, the overall package of credit card terms is in fact almost a living organism in the sense that it is difficult to focus on any single aspect and insist that it be standardized without taking into account all the remainder. It would be like, if I may make a limping analogy, suggesting that because consumers are confused by the variety of automobile lines and accessories that are available we can standardize by insisting that all cars be sold with six cylinders. That may produce some short-term benefit but it's doubtful whether it would entirely address the problems that are your basic concern.

Let me stop at that, Mr. Chairman, and I would be happy to answer any questions.

[The complete prepared statement follows:]

Senator Gorton and members of the Subcommittee on Financial Institutions and Consumer Affairs of the Senate Banking, Housing and Urban Affairs Committee, I am Professor Ralph J. Rohner, Special Counsel to the Consumer Bankers Association ("CBA"),<sup>1</sup> and professor of law at the Catholic University in Washington, D. C. I am appearing today on behalf of the CBA, and on behalf of VISA U.S.A. Inc. ("VISA"),<sup>2</sup> and MasterCard International, Inc., ("MasterCard")<sup>3</sup> both of whom are members of the CBA. My statement represents the views of all three organizations on the primary issues of the hearings held on Wednesday, May 21, 1986, before the Subcommittee: (1) whether the federal government should require all credit card issuers to include certain disclosures with applications, solicitations or advertisements provided to consumers; and (2) whether the federal government should

STATEMENT OF  
THE CONSUMER BANKERS ASSOCIATION  
MASTERCARD INTERNATIONAL, INC.  
AND  
VISA U.S.A. INC.  
BEFORE THE  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS  
OF THE  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
UNITED STATES SENATE  
MAY 21, 1986

1. The CBA is a nonprofit organization that was organized in 1919 to provide a voice for the retail banking industry. Today, membership in the CBA is open to any federally insured depository institution, including commercial banks, thrifts, and credit unions. Associate members include bank card processors and service provider organizations. Combined, the CBA members now hold over 70% of all consumer credit outstanding held by commercial banks and over 80% of the consumer deposit accounts held by commercial banks.
2. VISA is a membership association comprised of financial institutions in the United States which are licensed to use the VISA service marks in connection with payment systems, including credit cards.
3. MasterCard is a membership organization comprised of financial institutions which are licensed to use the MasterCard service marks in connection with payment systems, including credit cards.

require credit card issuers to adopt a uniform balance computation method for computing finance charges when credit is extended by a party other than a provider of goods and services. For the reasons set forth below, we are opposed to these proposals in general, and strongly opposed to such proposals when applied in a discriminatory fashion. We request that our views be made part of the record of the hearings.

We believe that additional consumer disclosure legislation is unnecessary at this time and therefore urge that the proposed disclosure provisions not be adopted. If, however, any new disclosure legislation is to be considered by this Subcommittee, we believe that it should await the completion of the Federal Reserve Board study, requested by Congress itself, regarding the relative benefits of providing consumers with additional comparative cost information about interest rates and fees. As noted below, the results of this study are expected to be released this Fall.

Moreover, we believe that if any additional disclosure legislation is favorably considered by Congress, the amount of required disclosure, and the circumstances under which such disclosure is required, must be carefully crafted in order to maximize its informational effectiveness and avoid serious practical and operational difficulties.

Without a limitation on the content and circumstances of any new disclosure requirements, the pending legislation will fail to accomplish its goal of creating a system for simplified comparison shopping of credit card programs.

Finally, we believe that any proposal for mandating a uniform balance calculation method for credit card accounts should be rejected as unnecessary and expensive, particularly when the balance method requirement would not be uniformly applied, and would discriminate against financial institutions which issue credit cards.

1. NEW DISCLOSURE LEGISLATION IS INCONSISTENT WITH RECENT CONGRESSIONAL SIMPLIFICATION EFFORTS AND COMPLICATED BY STATE LAW REQUIREMENTS.

When considering any proposal to amend the Federal Truth in Lending Act, it is vital for the Subcommittee to recognize that any modification of the disclosure requirements for consumer credit will alter a long-standing and intricately balanced compliance structure at both the federal and state level. For example, the Subcommittee will not be acting in a vacuum when considering the various disclosure bills. Any new disclosure requirements must be superimposed on an existing federal and state disclosure scheme which already includes initial disclosures, periodic or monthly

disclosures, disclosures in advertising, and a variety of related or even conflicting state law requirements. For example, Attachment A illustrates existing federal disclosure requirements of this type.

The Federal Truth in Lending Act has been in existence now for almost 20 years. It requires card issuers to disclose all major terms and conditions to each consumer before he or she becomes obligated on the account. All indications are that the Act has been successful in achieving its goal of promoting credit shopping by informing consumers of the most favorable credit terms. In 1977, for example, the Federal Reserve Board reported that consumer awareness of annual percentage rates for bank credit cards had increased from 26% in 1969 to over 71% in 1977. It should also be noted that consumer awareness of the cost of credit for retail revolving lines of credit in 1977 was 64.7%, more than six percentage points lower than that for bank credit cards.

This annual percentage rate awareness figure for bank credit cards was determined by the Board as a measure of a consumer's ability to shop for the least costly source of credit. In other words, as of 1977, over 70% of the consumers tested were able to shop effectively for the least costly source of credit in a bank credit card context. Although the 1977 data apparently is the most recently published Federal

Reserve Board information on credit card rate awareness, the Board's staff is presently completing its analysis of more recent survey data and anticipates releasing the results of this analysis this Fall. Moreover, in testimony before this Subcommittee on January 28, 1986, Governor Emmett J. Rice stated that the Federal Reserve is currently analyzing the results of a study, conducted at the request of Congress, to measure the benefits of providing consumers with comparative cost information about closed-end credit, and that this analysis, which is also expected to be available this Fall, should be helpful in considering the value of comparative rate data with respect to credit card interest rates and fees. In the meantime, it is our understanding that the level of consumer awareness regarding credit card rates is at least as high as in 1977.

Given the fact of nine additional years of exposure to information under the Truth in Lending Act, the level of consumer awareness of credit card rates has undoubtedly increased. Moreover, as this Subcommittee is well aware, no interest rates, with the possible exception of home mortgage rates, have received more publicity during the past year than credit card rates. Given this high level of consumer awareness, the value of legislation imposing additional and duplicative disclosure requirements must be considered in light of the potential for consumer confusion and information

overload, and the increased burdens and costs. In this regard, Congress, at a minimum, should await the results of the current Federal Reserve analysis of credit card rate awareness and the value of comparative rate data before pursuing any additional disclosure legislation.

In addition, any action by the Subcommittee affecting disclosure rules must be viewed in light of the history of the Truth in Lending Act itself. Each of the sponsors of the disclosure bills now under consideration has indicated that his bill is designed to increase price competition by requiring early disclosure of certain credit terms. In contrast, Congress actually relaxed the disclosure rules in connection with credit advertisements as part of the Truth in Lending Simplification and Reform Act of 1980, for the express purpose of "enhancing credit competition." The Report of the Senate Banking Committee indicated in 1980 that "lengthy" and "complex" disclosure requirements should be avoided in order to foster credit competition. This same rationale applies equally today and argues against the adoption of any legislation which would contradict Congressional efforts in 1980.

Similarly, the notion of mandating a uniform balance computation method was considered by Congress in 1973 and rejected. At that time, S. 2101 would initially have

mandated the use of the adjusted balance method, but was later amended also to allow the average daily balance method; eventually, however, uniform balance computation methods were rejected in full by the Senate Banking Committee. See, S. Rep. No. 278, 93rd Cong., 1st Sess. Given the fact that Congress considered and rejected a mandated uniform balance computation method in 1973, and has not raised the subject since that time, card issuers have relied upon the expectation that Congress would not require such uniformity in making the investment in the computer hardware and software necessary to operate credit card processing systems.

Moreover, given the comprehensive and integrated protections provided by the existing Truth in Lending Act and Regulation Z, we believe that additional disclosure requirements are both duplicative and unnecessary. The existing Act requires card issuers to disclose all major terms and conditions to each consumer before he or she becomes obligated on the account. While card issuers are provided with some flexibility as to the manner of providing these required disclosures, consumers must receive the disclosures before they are obligated to pay a cent.

Each consumer therefore has an opportunity to review all of the important terms and conditions of the account and compare them with the terms available under other financing



options. Further, the consumer can decline these terms and conditions without any obligation, and that is the end of the matter. Under existing Regulation Z, a creditor must even return any annual fee already paid. In other words, it is only after a consumer makes a fully informed decision to accept the disclosed terms and conditions that there is any obligation to pay an annual fee, interest or other charges. This information is far more comprehensive, for example, than the minimal credit information provided in sales catalogues and other retailer advertising materials used by consumers to buy goods or services on credit.

There are also significant legal and economic barriers to any efforts to implement the requirements that would be imposed under the proposed bills. Various state laws presently establish specific rules regarding disclosure and balance computation methods. In order to afford a quick and easy reference tool to facilitate comparison shopping, any new federal rules will have to provide for uniform disclosure. This, however, can only occur if there is full and absolute federal preemption of state law, even if state law arguably mandates different or more extensive disclosure.

Similarly, any efforts to implement a new federal requirement for a uniform balance computation method for credit card accounts will conflict with existing state law

notification and conversion rules. Not all states allow a creditor to alter the terms and conditions of a credit program and apply the new terms to existing balances. As a result, creditors could be required to run parallel systems in order to accommodate mandated changes.

Finally, the costs to the credit industry of these disclosure bills and balance method requirements would be enormous. New forms and procedures would be necessary to satisfy new disclosure requirements, and even larger capital outlays, including capital outlays for new computer systems, would be required to modify existing balance computation methods. In an industry where operating expenses are more significant than the cost of funds, we suggest it is paradoxical to impose requirements that will result in increased costs to card issuers in an attempt to reduce costs to consumers.

## II. THE VARIOUS DISCLOSURE PROPOSALS RAISE COMMON ISSUES.

Despite the present level of consumer awareness of credit card terms, Congress is considering various bills that would impose additional disclosure requirements in connection with credit card applications, pre-approved solicitations and, in some cases, even advertisements. We reiterate that we oppose any additional disclosure requirements as unneces-

sary at this time, and urge the Subcommittee to reject these legislative efforts. Nevertheless, we would like to comment on specific issues raised by these legislative proposals.

A. Only Written Solicitations Should Be Covered.

Presently, a great deal of general advertising for credit cards and credit card programs, including the national ad campaigns of MasterCard and VISA, is done through television, radio, and similar non-print media. While none of the bills before this Subcommittee currently requires additional disclosure in connection with such media advertising, our concern in this regard is not simply academic, since this issue is raised by legislation proposed in the House.

Requiring disclosures as part of television advertising, for example, would greatly increase the cost and reduce the effectiveness of a typical 30-second commercial. Moreover, advertisements for national multi-bank programs such as VISA and MasterCard are of necessity very general, with no specific terms to disclose. The various disclosure bills should not impose operational difficulties that would far outweigh the value of the added information to consumers. Otherwise, they could actually decrease competition by discouraging advertising. To prevent this result, new disclosure

legislation must make it clear that new disclosure requirements apply only to written solicitations or applications sent directly to consumers.

Furthermore, a very real distinction exists between "advertisements" and "solicitations." Advertising is designed to make a card issuer's credit program known generally. It is less immediate in its message. A single card issuer or a national credit card organization can publish or even mail to consumers general written advertising materials about its credit card program without including an application form or a solicitation response form. Such an advertisement, for example, can take the form of a brochure which discusses the various available consumer services (both credit and deposit), and invites the consumer to inquire about these services, but does not contain an application or a pre-approved request form. A general advertising brochure, even if sent directly to a consumer with his or her checking account statement, should not give rise to disclosure requirements. As long as the consumer must take the initiative to request an application or solicitation form to obtain a credit card, appropriate disclosures can come at that next stage.

Senator Gorton's bill (S. 2421) specifically refers to "advertisements" and could be interpreted as imposing new

disclosure requirements in connection with general advertising materials mailed to consumers. In 1980, the Senate Banking Committee, and Congress as a whole, voted not to impose new disclosure requirements for credit advertising, in order to encourage competition among card issuers. There is no reason to discourage such advertising now. The language of the Gorton bill should therefore be clarified by eliminating the term "advertisements," making it clear that materials sent to consumers would not give rise to disclosure requirements unless a solicitation form or application form were included.

B. New Disclosures Should Not Apply To All Credit Programs.

Some of the legislative proposals under consideration would impose new disclosure requirements in connection with all open-end consumer credit programs. Such a disclosure rule would apply to simple overdraft protection plans, as well as to real-estate secured or unsecured revolving lines of credit which are accessed by check or similar means. These programs differ from credit cards in terms of their purpose and usage patterns. We, therefore, recognize the importance of language included in all three Senate disclosure bills which limits the accounts subject to any new disclosure requirements.

But the proposed legislative language does not go far enough. For example, the broad language of the Dodd (S. 2140) and D'Amato (S. 2264) bills does not distinguish between direct-mail solicitations and applications which are generally available at branch, merchant and other locations.

Such "rack" or "take one" applications distributed through multiple locations of affiliated or unaffiliated entities would be impossible to retrieve and update, for compliance purposes, as account terms change. On the contrary, the sponsors of the various disclosure bills have focused on solicitations for credit card accounts. We believe, therefore, that any disclosure legislation should clearly indicate that it applies only to materials mailed directly to consumers, thus excluding rack and other generally available applications and advertising materials.

For example, the Gorton bill would apply only to "credit card solicitations . . . mailed to consumers." By using the word "mailed," S. 2421 makes it clear that it applies only to written material, not to oral or media solicitation. This same phrase also makes it clear that "rack" or "take one" brochures or applications which are not sent to the consumer by the card issuer are not subject to additional disclosure requirements. If there is to be any new disclosure legislation, it is very important that it include such restrictive language.

C. Disclosures Should Be Permitted To Accompany Applications Or Solicitations.

Certain of the current legislative proposals could require card issuers to include required disclosure items in the solicitation or on the application itself. The Dodd bill (S. 2140), on the other hand, makes it clear that any required disclosures can also be included on materials which accompany the application. This language provides very important flexibility. It is unnecessary for any required disclosures actually to be printed on the forms themselves, and such a requirement would greatly increase the costs of producing credit card solicitations and applications.

For example, a requirement that the terms be printed on the application form itself could preclude a card issuer from printing applications in large quantities to take advantage of volume discounts, since changes in account terms generally occur far more frequently than the application forms themselves require modification. As a result, requiring the inclusion of disclosures in preprinted forms would invariably lead to inefficiency and waste, particularly in connection with variable rate programs. In addition, such a requirement could preclude a financial institution from using the same application form for multiple purposes, such as credit card accounts, automobile or student loans, and other consumer credit programs.

We recommend that card issuers be allowed to fulfill any disclosure requirements by providing the disclosure information on materials which accompany solicitations or application forms, as permitted by the Dodd bill. This would allow sufficient flexibility to accommodate industry needs and, at the same time, permit card issuers to provide any required disclosure information on or with solicitations and applications mailed directly to consumers.

D. No Particular Format Should Be Prescribed.

While not currently required by any of the Senate bills, certain legislative proposals would also require that card issuers provide disclosure information in a mandated format or through use of sample tables approved by the Federal Reserve Board. We believe that card issuers should be given the flexibility to provide any required disclosures in a manner which best fits the particular product and circumstances at hand. A "clear and conspicuous" standard should be sufficient in connection with solicitations or applications, just as it is with the other disclosure requirements mandated by Regulation Z.

After nearly a dozen years of experience with Regulation Z disclosure requirements, Congress, in the Truth in Lending Simplification and Reform Act of 1980, decided to

replace the type size and location requirements for open-end credit with a "clear and conspicuous" standard. The Subcommittee should not ignore this history in considering any new disclosure requirements for credit card accounts. Statutorily prescribed tables are restrictive, do not add to consumer understanding, place unnecessary constraints on creditors, impede the ability to provide additional information voluntarily, give rise to technical litigation, and ultimately prove more costly to consumers.

E. The Proposed Legislation Should Amend Section 143.

Presently, the bills introduced by Senators D'Amato, Dodd and Gorton would each amend Section 127 of the Truth in Lending Act, which deals with the comprehensive disclosure requirements for specific open-end consumer credit accounts. For purposes of statutory uniformity, it would be more appropriate, however, for any such legislation to amend Section 143 of the Act, which governs advertising of open-end credit plans. Indeed, as presently constituted, Section 143 already takes into account special forms of advertising such as catalogues and oral disclosures. The special treatment afforded mail solicitations by the bills under consideration appears to align more logically with Section 143. Senator Gorton's bill in particular belongs under Section 143 since

his legislation specifically addresses advertisements and solicitations. Likewise, the D'Amato and Dodd bills also attempt to provide certain limited information on an early basis, and thus it is more appropriate to incorporate these requirements into Section 143.

In addition, the Subcommittee should make it clear that the early disclosure of any items required under these bills will not "trigger" the need for additional disclosure under existing Section 143 and corresponding Federal Reserve Board regulations. Presently, the advertising regulation require a card issuer who discloses any of the items which are required as part of the initial disclosure statement, including annual percentage rates and annual fees, to also disclose the periodic rates and certain other information. In other words, some of the terms which the pending bills would require to be disclosed could, under the advertising rules, "trigger" the need for further disclosure. Therefore, any such legislation must make it clear that any required text will not trigger the need for additional disclosure under the advertising rules. This clarification could best be accomplished if any new requirements are developed through a modification of Section 143 itself, rather than through a cross reference to some other section of the Truth in Lending Act.

F. Exemptions Should Not Be Provided For Competing Credit Cards.

A proposed amendment to the Dodd bill would exempt travel and entertainment cards which have an "ancillary," or standby, credit feature from any new disclosure requirements.

As a practical matter, travel and entertainment cards which can access a standby line of credit, such as the American Express Gold Card, are indistinguishable from typical bank credit cards. Holders of these cards can repay in full each month, and avoid finance charges, or repay in installments (through access to the standby line of credit) and incur a finance charge. From a competitive standpoint, such a program is virtually indistinguishable from a bank credit card program which offers a one month free-period. Unless consumers are able to compare both types of programs, the ability of any new disclosure requirements to permit consumers to shop for credit among all competing credit cards is eliminated. As a result, we believe that any disclosure requirements imposed on card issuers by the D'Amato, Dodd or Gorton legislation should be made equally applicable to travel and entertainment cards with standby credit facilities. If proposed disclosure requirements present operational problems for such card issuers, alternative methods of disclosing the same information should be provided, rather than an exemption which would limit the ability of consumers to comparison shop and would disadvantage

competing card issuers. Moreover, any such disclosure alternatives must be equally available to all card issuers.

Similarly, a proposed amendment to the Schumer-Roth bill in the House (H.R. 4197) would provide a special disclosure rule for certain national retailer credit card programs. Such retailer credit card programs also compete directly with bank credit card programs on both a local and national basis for consumer credit card accounts. Like bank card programs, some retailers offer different terms in different states and other retailers "export" terms across state lines. The exportation of credit card terms across state lines presents issues for both banks and retailers alike. There is simply no justification for special disclosure rules for retailers or for any other special group of card issuers. If compliance alternatives are to be included in any disclosure legislation, they must be made equally available to all card issuers.

Again, we would prefer to see no new disclosure legislation at all. If legislation is enacted, however, any resulting disclosure requirements should apply equally to travel and entertainment cards, national retailer cards, and any other credit cards which compete with bank credit cards.



III. ANY REQUIRED DISCLOSURE TERMS SHOULD BE LIMITED TO THE ANNUAL PERCENTAGE RATE AND ANNUAL FEE.

Consumers already receive complete disclosure of all fees, charges and conditions imposed in connection with credit accounts prior to becoming obligated to the card issuer. New disclosures should not substantially duplicate the initial disclosure statement terms. On the contrary, if a quick and simple method for comparative shopping is the goal, required information should be kept to the absolute minimum. It should focus on the most obviously "shopable" aspects of the credit plan, those that will always affect the consumer's costs.

We suggest therefore that any disclosures be limited to annual percentage rate or rates and the dollar amount of any annual fee. In particular, such legislation must avoid terms, such as the balance computation method or the circumstances under which a free-period is available, which require a narrative description or explanation by the card issuer. These disclosure provisions become even more complex where the terms are different for purchase transactions and cash advance transactions under a credit card account. In 1980, Congress specifically rejected disclosure in advertisements of the balance computation method as too lengthy and complex, and settled on disclosure of only two items:

the annual percentage rate and any minimum or fixed fees. The same reasoning applies to disclosures in solicitations and applications. Since the stated purpose of an early disclosure requirement is to allow quick comparisons among credit card accounts, requiring the disclosure of terms that must be described or explained in extended narrative form would be contrary to the goals of the various disclosure bills.

A. Annual Percentage Rate Disclosure Must Accommodate Multiple Rates And Variable Rates.

All of the disclosure bills would require card issuers to disclose the annual percentage rate. We would like to make two suggestions in this regard. First, we suggest that the annual percentage rate disclosed under any such legislation be computed by multiplying each periodic rate or rates that can be imposed on purchases by the number of periods in a year. This formulation parallels that used to compute the annual percentage rate for purchases that must be disclosed in the initial disclosure statement under Regulation Z. 12 C.F.R. § 226.14(b).

In addition, any disclosure requirement must accommodate credit card programs with variable interest rates, which may change after a solicitation has been mailed. This could be done by allowing card issuers offering variable

rates the alternative of disclosing the manner in which the variable rate or rates are determined. Specifically, such a disclosure provision might allow the card issuer to identify the index and the spread used to determine the rate.

B. The Annual Fee Disclosure Must Also Be Narrowly Defined.

Senator Dodd's bill (S. 2140) would require the disclosure of "any annual or other fee imposed for the issuance or use of that credit card" (emphasis added). Similarly, Senator Gorton's bill (S. 2421) would require disclosure of "annual fees and other charges, if any, applicable to the issuance or use of the credit card" (emphasis added). It is not immediately apparent what the term "other fee" or "other charges" means in this context. As used in existing Section 127 of the Truth in Lending Act, disclosure of "other charges which may be imposed as part of. . . [an open-end credit] plan" means disclosure of all charges other than finance charges. Regulation Z also uses the phrase "other charges" to mean "any charge other than a finance charge that may be imposed as part of. . . [an open-end] plan." 12 C.F.R. § 226.6(b). Such an interpretation would require, for example, the disclosure of such fees as late charges, overlimit fees, overdraft fees, application fees and default charges, if such fees are "applicable" to the use of the card.

It is even less clear what "any other fee" is intended to mean, since this term is not addressed under the existing law. As a result, "any other fee" in S. 2140 could be interpreted as requiring the disclosure of all other account terms which may result from the use of the account, including all finance charges.

Either interpretation would greatly increase the length of any resulting disclosure document and would complicate any effort to comparison shop by introducing numerous fees and charges other than a traditional membership or participation fee. This result clearly could not be intended by the sponsors of the legislation being considered by this Subcommittee. On the other hand, such a disclosure provision could be limited to membership fees and could address both annual and more frequent fees by stating, for example, that the card issuer must disclose "any membership or participation fee that may be imposed for availability of a credit card account, expressed as an annualized amount."

C. Free-Period Disclosure.

The D'Amato, Dodd and Gorton bills would all require card issuers to disclose any free-period in connection with credit card accounts. For example, S. 2421 would require disclosure of "the conditions under which a finance

charge may be imposed, including the time period (if any) within which any credit extended may be repaid without incurring a finance charge." This "free-period" disclosure provision is taken directly from Section 127(a) of the existing Truth in Lending Act, which sets forth the more comprehensive disclosure requirements for initial disclosure statements. This requirement would lead to a lengthy explanation of such features as the method of posting debits and credits to the account, and "hidden" grace-periods or forgiveness periods, as well as free-period distinctions for purchases and cash advance transactions permitted or required under state law. Any such analysis or explanation would greatly complicate the disclosure and limit its usefulness for comparative shopping.

In this regard, we strongly urge that any disclosure of the free-period be limited to purchase transactions alone. Purchase transactions are, by far, the most common credit card transactions. As a result, consumers are much more likely to be concerned with free-periods applicable to purchase transactions than with those applicable to cash advance transactions. Limiting disclosure of free-periods to purchase transactions would simplify the content of the disclosure, provide consumers with the most useful free-period term, and increase the likelihood that any particular consumer will in fact go through the effort of comparison shopping.

Because most credit card programs offer a free-period for purchases, and because consumers in many states expect such a free-period, card issuers should only have to make this disclosure if they elect not to offer such a free-period by specifically stating, for example, "no free-period for purchases."

Any affirmative disclosure of free-periods actually offered for purchases should be based on the simplest possible formula utilizing existing Regulation Z concepts. First, the term used could be "free-period" rather than "grace-period," since "grace-period" describes the few, normally undisclosed, days after the payment due date which are allowed to accommodate postal delays. See 12 C.F.R. § 226.7(j). Furthermore, disclosure could be limited to a single number, perhaps the number of days between the "billing date" or "statement preparation date" and the "payment due date" for purchases. For example, such a disclosure provision could require a card issuer to state "the number of days in any 'free-period' for purchases, calculated from the billing date to the payment due date." If no free-period is provided for purchases, the card issuer might simply state "none" or "no 'free-period' for purchases." This would employ terms and concepts that are familiar to card issuers and consumers and inform consumers of the length of time they have until additional finance charges begin to accrue. Such an approach would

also avoid the need for lengthy discussions of forgiveness periods and hidden grace periods.

Recent press releases published by Representative Charles Schumer of New York may well demonstrate how such disclosures can provide meaningful shopping information. In addition to the annual percentage rate and annual fee, the releases published by Representative Schumer disclose minimal information about the free-period for purchase transactions only. For example, Representative Schumer's list allows a consumer to compare credit cards offered by a Maryland savings and loan and a Maine bank identified in that list as follows:

Maryland Savings And Loan  
Interest rate: 14 1/4  
annual fee: \$16  
grace period: 30 days

Maine Bank  
Interest rate: 16.98%  
annual fee: \$24  
grace period: none

It is apparent that Representative Schumer assumed disclosure of these three terms was sufficient to allow consumers to comparison shop. Therefore, if any disclosure legislation is adopted, card issuers should be required to disclose, at most, only these three terms.

#### IV. FEDERAL PREEMPTION OF STATE DISCLOSURE PROVISIONS IS ESSENTIAL.

The intent of the various disclosure bills before Congress is to provide consumers with a simple, uniform disclosure which will facilitate easy comparison shopping. To accomplish this, it is important that individual states not be allowed to vary the content, circumstances or manner of the disclosure. Thus, complete federal preemption with respect to any such disclosure requirement is essential. States must not be allowed to vary the content or timing of the disclosures, even if a particular state legislature or court believes that different or additional disclosure requirements will give greater protection or benefit to consumers.

Furthermore, the stated goal of the sponsors of the various disclosure bills is to reduce credit card costs. A failure to absolutely preempt related state law disclosure statutes would have exactly the opposite effect. Confusion or modifications caused by differing state law requirements increases the costs of operating credit card programs for local and interstate programs alike, and thus increases the costs of credit to consumers.

V. CONGRESS SHOULD NOT MANDATE A UNIFORM BALANCE COMPUTATION METHOD.

Unlike the other legislative proposals, S. 2421 would also require certain card issuers to adopt as their balance computation method either the "average daily balance method" or an alternative method which "results in lower finance charges." This requirement would only apply, however, "if credit may be extended by a party other than the provider of goods or services." The proposed mandatory "uniform" balance calculation requirement would not apply to credit cards issued by retailers or other providers of goods and services except, apparently, where such cards can also be used for purchases from other providers of goods and services. This would be the case, for example, where an oil company credit card could also be used at a hotel or where a credit card issued by one retailer could be used at other retail stores.

We strongly oppose as unnecessary and costly any legislation to mandate a single balance computation method for credit card issuers, whether that method is the average daily balance or some alternative balance computation method. In particular, we strongly oppose the imposition of any balance computation requirement on financial institutions that issue credit cards where the requirement does not apply equally to all other entities that issue competing cards.

A. Mandating Use of Average Daily Balance Cannot Achieve Its Stated Goal.

According to accompanying introductory materials, S. 2421 would require bank credit card issuers to use the average daily balance method of balance computation in order to "deal with the problem of unfair balance computation methods." We believe that the proposal cannot possibly achieve this goal. First of all, the proposal does not in fact mandate a single balance computation method even for bank credit card issuers. Instead, card issuers would be permitted to employ alternative balance computation methods, so long as the method or methods selected result in lower finance charges than the average daily balance method.

The proposal fails to recognize, however, that virtually any balance computation method can result in lower finance charges than the average daily balance method under certain circumstances. For example, although it has been characterized in introductory language to the bill as an "egregiously unfair method," the "ending balance" method can often result in lower finance charges than the average daily balance method.

Assume, for example, that a consumer makes purchases totalling \$200 on the fifteenth day of the month and makes a \$150 payment on the last day of the month. Under the end-

ing balance method, the balance which would be subject to a finance charge would be \$50 (\$200 in purchases minus the \$150 payment). If, however, the card issuer uses the average daily balance method, the balance which is subject to finance charge would be \$101. This is because you add up the daily balances and divide by the number of days in the month to calculate the average daily balance. (In this example, the balance would be zero for 14 days, \$200 for 15 days and \$50 for the final day, which results in an average daily balance of \$101.) Therefore, the ending balance method would result in less than half the finance charges for consumers in this payment setting. A similar result would occur in almost any month where purchases occur early in the month and payments or other adjustments occur later in the month.

Although other balance computation methods can result in lower finance charges than the average daily balance method under certain circumstances, these effects can only be known with hindsight. It is therefore not at all clear whether or when such alternative methods result in lower finance charges for purposes of the proposed legislation. Stated another way, how much of the time must a particular balance computation method result in lower finance charges in order to remain available to card issuers: occasionally? frequently? half of the time? most of the time? all of the time?

In fact, whether a particular balance computation method results in lower finance charges depends in large measure on the purchasing and payment habits of individual consumers. As a result, it will be extremely difficult, if not impossible, for the Federal Reserve Board to determine, in connection with a particular credit card program, whether a particular balance computation method actually yields a higher or lower finance charge than the average daily balance method. If hypothetical assumptions of consumer use and repayment practices are employed, the information will not necessarily reflect the practices of individual consumers. Yet it would be prohibitively expensive and clearly unworkable to attempt to compare the effect of balance computation methods based on individual consumer use and repayment practices. A card issuer simply cannot establish discrete balance computation methods to fit each consumer's practices. Alternatively, the Federal Reserve Board could allow certain assumptions to be made based on the card use and repayment practices of a plurality of a particular consumer base. These assumptions, however, would still differ from card issuer to card issuer and would only be valid as long as the particular card issuer's consumer base did not change.

The point, of course, is that the use and repayment practices of the entire consumer base, as well as of individual consumers, are not static conditions. On the contrary,



creditor will result in lower finance charges than the average daily balance method. A consumer looking at any given card program would not necessarily be able to tell whether it uses a method which results in lower finance charges.

Even more significantly, the legislation would intentionally apply this balance computation method in a non-uniform fashion. It would exempt from any balance computation requirement credit cards issued by retailers, oil companies and others who finance the goods or services they sell, and in doing so compete directly with the credit card programs offered by financial institutions. If such a large segment of the credit card market were exempt from any resulting requirement, the balance computation proposal could not possibly permit consumers to select between competing credit options.

Some retail credit cards, in fact, share many of the attributes of third party credit cards in that they can be used to obtain on credit goods and services sold by other entities. For example, as noted above, oil company credit cards can be used at hotels and to rent cars, and certain retail cards are accepted at a variety of locations under cooperative arrangements with other retailers. Other retail card programs include check cashing privileges comparable to bank card cash advances. These multi-purpose retail cards

they change frequently. A requirement that the Federal

Reserve Board determine whether a given balance computation method truly yields a finance charge lower than that which results from the average daily balance method is therefore unworkable in practice. Moreover, because the impact of a mandatory balance method depends on the payment practices of particular consumers, any effort to impose a uniform balance computation method or to eliminate methods which are perceived to be unfair by some may actually deprive consumers of the advantages they may currently enjoy under their existing credit card programs.

B. The Required Balance Proposal Will Not Help Consumers to Distinguish Between Credit Card Accounts.

The principal justification for including a balance computation requirement in such a credit card disclosure bill is to enable consumers to distinguish between competing credit card programs and select the most favorable program. However, the existing proposal does not achieve this result. As noted in the introductory language to the bill itself, the proposal would not address distinctions in the free-ride features of various credit card accounts. More importantly, the proposal does not actually require the use of the average daily balance method, so long as the method selected by the

must be included within the proposed legislation; any other result would inhibit the ability of consumers to comparison shop for competitive credit card accounts.

C. Legislation Should Not Discriminate Among Creditors.

We strongly object to the exemption included in S. 2421 for "providers of goods or services," which is principally designed to exempt retailers and oil companies from the proposed "uniform" balance calculation method. Retailers provide credit services which are essentially competitive with the credit services of banks, and we believe that it is unfair to treat providers of what are comparable services in an uneven and inconsistent manner. The principal justification for requiring a uniform balance computation method is to facilitate the ability of consumers to quickly and easily compare credit card rates and fees. The exclusion of retailers and other sellers of goods and services from the uniform balance computation requirement, however, makes any meaningful comparisons impossible.

Moreover, any argument that retailers should be exempt because they do not offer multi-state programs under which they "export" credit card terms ignores the marketplace reality that some retailers, like some banks, export credit

card terms and that such interstate programs raise state law issues for both retailers and banks. In addition, the legislative exemption, if granted, would apply to the largest single segment of the credit card market. According to a report on credit card accounts and practices released in April 1986 by the Federal Reserve Board, based on their 1983 Survey of Consumer Finances, 57 percent of all U.S. families hold retail store credit cards, as compared to 42 percent for bank credit cards (Report at page 3-2). According to a recent study by Lexecon, Inc., 91 million Americans had a total of 354 million retail card accounts at the end of 1984, while the total of active MasterCard and VISA accounts at the end of 1984 was 64.5 million. It is also significant to note that the Federal Reserve Board report indicates that nearly half of both bank and retailer credit card users appear to be convenience users (who do not regularly pay finance charges) (Report at page 1-4), but that retail credit card issuers, unlike banks, can increase the prices of merchandise financed in order to compensate for economic changes in their card programs (Report at page 4-5). Thus, a special accommodation for retailers is difficult to justify.

The proposed retailer exemption is particularly objectionable on another ground. The introductory statement for the legislation explains that most financial institutions have already adopted the average daily balance method and

that the remaining financial institutions are "bad actors" who continue to use "such egregiously unfair methods as the 'previous balance' method and the 'ending balance' method." But studies, like that conducted recently by the University of Virginia at the request of the Virginia legislature, have shown that retailers are, in fact, not only resisting movement towards the average daily balance method, but that some retailers are continuing to use a balance computation method (the previous balance method) which is generally recognized to be the least favorable to consumers and which is illegal under the laws of some states. Under these circumstances, it is simply not fair to designate financial institutions as the "bad actors" and to single them out for special treatment.

D. Conversion Costs Would Be High And The Adverse Impact of A Mandated Method Could Be Substantial.

Card issuers and service organizations have invested millions of dollars in computers and software programs in connection with their existing billing systems. As noted above, Congress clearly signaled in 1973 that it preferred not to restrict billing system options, and countless creditors have relied on that Congressional rejection of mandatory balance methods. Federal legislation mandating the use of the average daily balance method would require extensive and expensive

changes in the billing systems of card issuers not presently using the average daily balance method. Such changes could take years to implement fully. Besides revising and testing new programs, or purchasing qualifying services from third party processors, card issuers would need to revise and reprint both the initial disclosure statements and monthly statements which are already required by the Truth in Lending Act.

Based on a preliminary review of information relating to existing bank credit card programs, we estimate that 15% to 20% of all bank card issuers do not presently use the average daily balance method. Rather, these institutions use a variety of other methods such as the daily balance method, the adjusted balance method and the ending balance method. Requiring the average daily balance method could force such financial institutions to modify their balance computation methods by making unlawful, for example, the ending balance method, or even the actuarial daily balance method which may actually provide the most accurate calculation of the outstanding balance by applying a finance charge rate to the actual amount of credit outstanding each day. Furthermore, the legislation fails to reflect the fact that there are also many variations of the average daily balance now in use, and that these methods can result in substantially different finance charges depending on other account features, such as free-periods and compounding. In fact, the amount of finance

charges resulting from various average daily balance programs can actually differ more significantly than when compared to programs using other balance methods.

Moreover, the balance computation methods selected by certain card issuers are designed to permit them to partially compensate for usury ceilings and other limitations (such as restrictions or limitations on annual fees) imposed under state law. In Texas, for example, where most card issuers are subject to usury limitations, and where annual fees are prohibited, financial institutions commonly use an actuarial method of computing the balance subject to finance charge under which a daily rate is applied to the balance each day, without regard to average balances and without the use of *free-periods*. Any legislation which would restrict the use of the existing balance computation methods used by such financial institutions would severely affect their ability to offer credit card services. Similar problems would be faced by financial institutions in other states which impose such usury limitations on credit card accounts.

Furthermore, the costs of converting existing systems or of acquiring new systems necessary to comply with a uniform balance computation method would be very expensive. This may be particularly true in the case of small financial institutions and service organizations. In other situations,

the card issuer may be able to withstand the conversion costs, but could not successfully operate the credit card program using a required balance computation method, given other statutory and regulatory restrictions under which that institution must operate.

E. There Are Substantial Legal Barriers To Implementing A Uniform Computation Method.

According to Federal Reserve Board interpretations, any change in the balance computation method for credit card accounts is an "adverse change" requiring advance notice under the Truth in Lending Act. In addition, some states (particularly the Uniform Consumer Credit Code states) require lengthy notice periods for a change in the terms applicable to credit card accounts. In some instances multiple notices over a two or three month period preceding the effective date of the change are required. Finally, some cardholder agreements simply do not reserve the right to change the terms of the account relationship. In other words, some card issuers have not retained the contractual right to alter a cardholder's existing balance computation method.

Moreover, in some states, a change in terms is only effective for new transactions which occur after the effective date of the change or any mandated notice requirement.

That is, changes in terms cannot be applied to existing balances. In addition, many credit card agreements allow cardholders to repay any outstanding balance under existing terms, rather than accept a new change in terms. The minimum payment provisions of these agreements normally allow a great deal of time, often years, before a consumer's outstanding balance is repaid in full.

For all these reasons, many card issuers and servicing organizations could be required to maintain parallel billing and processing systems. Costs, again, would be substantial. For many small card issuers, and for some third party processors, it would be difficult, if not economically impossible, to maintain such parallel systems. Alternatively, Congress would have to preempt generally all state contract laws and statutory requirements which would otherwise preclude card issuers from immediately implementing a change in their existing balance computation methods.

#### V. TRANSITIONAL PERIODS.

Based on the operational difficulties discussed above, and the many other issues which would arise during implementation, we request that the Subcommittee include lengthy transition periods in any legislation reported favorably out of the Subcommittee. We suggest that any disclosure

requirements not become mandatory for at least one year after the passage of legislation. Furthermore, any requirement for the use of the average daily balance method, or any other method of computing finance charges, should not become effective for at least three years after enactment.

\* \* \* \* \*

We appreciate the opportunity to include our views on this matter as part of the record of the hearings.

## ATTACHMENT A

CURRENT CREDIT CARD DISCLOSURES REQUIRED BY  
TRUTH-IN-LENDING ACT ("Act")/REGULATION Z ("Reg. Z")\*Advertising (Act §143;  
Reg. Z §226.16)

- Must be accurate.
- Must reflect terms actually offered.
- Use of "trigger" term requires additional disclosures.
  - e.g. trigger term:
    - 17 % A.P.R.
  - Small monthly service charge on remaining balance.
  - \$20 Annual membership fee buys you \$2,000 in credit.
  - No finance charge if you pay your full balance each month.
- "Required" additional disclosures:
  - Any minimum, fixed, transaction, activity or similar charge that could be imposed.
  - A.P.R. and variable rate, if applicable.
  - Membership or participation fee

Initial Statement (Act  
§127; Reg. Z §226.6)

- (Written disclosures made to consumer before 1st transaction)
- Finance charge: explanation of charges, methods of computation, free ride periods, periodic and annual rates and when they apply
- All other charges that may be imposed
- Security interest, if applicable
- Statement of federal billing rights
- 2 right of rescission notices if credit plan is secured by consumer's dwelling (see Act §125; Reg. Z §226.15)

Periodic Statements  
(Act §127; Reg. Z §226.7)

- Previous balance
- Identification of each transaction during the period
- Credits to the accounts
- Periodic and annual rates
- Balance to which finance charge is applied and how it is computed
- Amount and components of finance charge
- Actual A.P.R. for the period
- Other charges itemized and identified
- Closing date of billing cycle
- New balance on that date
- Free ride period
- Address for notice of billing errors

Subsequent Disclosure  
Requirements (Act  
§122; Reg. Z §226.9)

- Statement of federal billing rights, at least annually
- New credit devices/features added to plan must be disclosed prior to usage by consumer
- A change in terms must be disclosed at least 15 days prior to effective date of change
- Right of rescission notice, if applicable, whenever credit limit is increased (see Act §125; Reg. Z §226.15)
- Billing error resolution notices to consumers and others (see Act §170; Reg. Z §226.13(c), -(e) and -(g))

\* Act - 15 U.S.C §1601 et seq.  
Reg. Z - 12 CFR Part 226



Senator GORTON. Thank you, Mr. Rohner. That was very clear testimony and we will look carefully at all of your detailed testimony.

Ms. Fernstrom.

**STATEMENT OF MEREDITH FERNSTROM, SENIOR VICE PRESIDENT, OFFICE OF PUBLIC RESPONSIBILITY, AMERICAN EXPRESS CO.**

Ms. FERNSTROM. I think in the interest of open disclosure, I should note that I am Ms. Fernstrom and not Mr. Fernstrom, as is noted on my nameplate.

Senator GORTON. We noted the difference.

Ms. FERNSTROM. My name is Meredith Fernstrom. I am senior vice president for public responsibility at American Express Co. I am very pleased to have this opportunity to appear before the subcommittee.

American Express has long been regarded as a leader in our commitment to the consumer. I've outlined some of our activities in my statement, which I would like to submit for the record. I would point out just a couple of examples, which are consumer information publications on women's credit rights, credit card fraud, how to buy insurance, and so on. Some of these were done in conjunction with the Federal Trade Commission. We've issued to date over 2 million copies of these brochures free of charge to the public.

Because of our strong commitment to the consumer, we are very supportive of your efforts to require more open and full disclosure to the consumer, but we would like to take this opportunity to call to your attention some practical problems involved in complying with these disclosures, and to offer some recommendations which we believe will help resolve these problems both to the benefit of creditors and the consumer.

**FEATURES OF CHARGE CARDS**

I would point out first of all that American Express cards are not credit cards. They are charge cards. And unlike virtually all bank and most retail credit cards, we do not offer automatic open end credit. Each card member's balance must be paid in full upon receipt of his or her monthly statement. Therefore, no finance charge is imposed on charges incurred on their card account.

If a card member fails to pay in full, collection activity ensues and the account may be canceled. As a result, it's virtually impossible for us to comply with the disclosure requirements proposed in the legislation that is pending before this subcommittee.

For example, our gold card, which like our other cards, requires full payment upon receipt of a monthly statement, also provides a card member with an ancillary but independent open end line of credit offered not by us as the card issuer, but rather by 1 of 2,300 depository institutions nationwide.

As far as we know, our gold card program is unique in the charge card industry and presents particular disclosure problems in the context of the bills that are before you.

The line of credit, as I mentioned, is an ancillary feature of card membership and one of several service enhancements to the gold card. This line cannot be accessed directly through the gold card. It is an option that need never be used by the card member and is generally accessible only via checks or drafts drawn on the participating depository institutions.

Credit extended under these lines is separately billed to card members directly by those institutions.

At the time that a consumer applies for a gold card, the depository institution which will become the creditor for the line of credit is not known by American Express. After an application is received, it is assigned to a depository institution which then makes its own credit decision for the line of credit. Depository institutions are assigned according to several factors. These include the location of the applicant, the applicant's current bank relationships, and the credit criteria that are used by each institution.

To further complicate matters in terms of the proposed disclosures, each institution sets its own terms for the line of credit, including the APR, the finance charges and access to the account. None of these terms are known by us at the preapplication stage, making it virtually impossible for us to comply. The terms are separately disclosed to the card member directly by the depository institution before or at the time that the line of credit is made available.

What we would like to recommend for your consideration is that the bills be amended to recognize the distinctions between credit cards and charge cards and to require different and distinct disclosures on their respective applications. We have drafted proposed amendments to the three bills which are designed to achieve these goals.

Senator GORTON. Excuse me. Ms. Fernstrom, you are not objecting to disclosure; you simply want a disclosure which will fit the kind of business you're in?

Ms. FERNSTROM. Yes, sir.

Senator DODD. Mr. Chairman, I think Ms. Fernstrom has raised an excellent point. I think it's very, very legitimate and I think we can accommodate the gold card issue within the context of the bills before us, but she raises a very legitimate point, one that we didn't think of in the proposals.

Senator D'AMATO. I'll make it unanimous.

Ms. FERNSTROM. Shall I leave my time to the final witness?

Senator DODD. Leave while you're ahead.

[The complete prepared statement follows:]

STATEMENT OF AMERICAN EXPRESS COMPANY

Good morning. My name is Meredith Fernstrom. I am Senior Vice President for Public Responsibility at American Express Company ("American Express"). I welcome this opportunity to address the Subcommittee regarding the legislative proposals before you.

STATEMENT OF  
MEREDITH M. FERNSTROM  
SENIOR VICE PRESIDENT - PUBLIC RESPONSIBILITY  
AMERICAN EXPRESS COMPANY

American Express has long been regarded as a leader in our commitment to the consumer. We have a variety of policies and programs which are designed to assist our customers and the general public in exercising their consumer rights and making informed choices in the marketplace. For example:

- o Our series of consumer brochures called "ConsumerCards" cover topics including women's credit rights, mail order rights, how to buy insurance, and how to avoid credit card fraud. Several of these were done in collaboration with the Federal Trade Commission.

We have distributed almost two million copies of these booklets to the public at no charge.

- o We also provided grants to the Consumer Federation of America for the production of two of its recent consumer brochures, "Your Savings Options" and "Your Credit Options," which advise consumers how to shop wisely for savings and credit products.
  - o We are sponsoring a series of seminars to be conducted in five cities by the Harlem, New York Consumer Education Council, to assist low-income consumers in establishing or re-establishing credit.
  - o We recently launched a series of seminars on credit and financial planning for U.S. military personnel stationed abroad, in conjunction with the Department of Defense and our Military Bank Division.
  - o American Express was recently honored by Consumer Digest magazine for our "excellent consumer education programs and the establishment of a Public Responsibility position to ensure accuracy in advertising."
- Because of our strong commitment to the consumer's interest, we support the efforts of the Senate Banking Committee to require full and fair disclosure in open-end credit applications. Nevertheless, we wish to take this opportunity to call your attention to some of the practical problems involved in complying with the credit card application

Testimony before the  
U.S. Senate Committee on Banking,  
Housing and Urban Affairs  
Subcommittee on Financial Institutions  
and Consumer Affairs

May 21, 1986

disclosures proposed by pending legislation and to offer suggestions to resolve these problems which we believe will ultimately benefit both creditors and consumers.

American Express Cards are not credit cards -- they are charge cards. Unlike virtually all bank and most retail credit cards, American Express Cards do not offer automatic "open-end" credit. Each Cardmember's balance must be paid in full upon receipt of his or her monthly statement. No finance charge is imposed on charges incurred on Card accounts. If a Cardmember fails to pay in full, collection activity ensues and the account may be cancelled. As a result, it is virtually impossible for us to comply with the disclosure requirements proposed in legislation pending before this Subcommittee.

We support the Subcommittee's goal of clarifying the terms and pricing of the many credit cards offered to consumers. Through clear disclosures, consumers will be able to make more informed decisions when choosing credit products. In reviewing the language of the proposed bills, however, we are concerned that they might be interpreted in a way which would mislead rather than enlighten consumers on the nature of the American Express Card.

For example, our Gold Card, which like our other Cards requires full payment upon receipt of a monthly statement, also provides a Cardmember with an ancillary independent open-end line of credit offered not by the card issuer, but by one of 2,300 depository institutions nationwide. As far as we know, our Gold Card program is unique in the charge card industry and presents particular disclosure problems in the context of the bills before the Subcommittee.

The line of credit is an ancillary feature of Card membership, one of several service enhancements to the Gold Card. This line cannot be accessed directly through the Gold Card. It is an option that need never be used and is generally accessible only via checks or drafts drawn on the participating depository institutions. Credit extended under these lines is separately billed to Cardmembers directly by those institutions.

At the time that a consumer applies for a Gold Card, the depository institution, which will become the creditor for the line of credit, is not known by American Express. After an application is received, it is assigned to a depository institution which makes its own credit decision for the line of credit. Depository institutions are assigned according to several factors including the location of the applicant, the applicant's current bank relationships, and the credit criteria required by each institution.

To further complicate matters in terms of the proposed disclosures, each institution sets its own terms for the line of credit, including annual percentage rates, accrual of finance charges, and access to the account. None of these terms are known by us at the preapplication stage, making it impossible for us to comply.

In accordance with current Truth in Lending Act regulations, these terms are separately disclosed to the Cardmember directly by the depository institution before or at the time the line of credit is made available. In fact, it is important to emphasize that none of the bills purport to require disclosures on the various independent line of credit products offered by institutions around the country. The language as drafted, appears to require that only American Express provide such disclosures and for lines we do not even offer or control directly. We do not believe this was intended by the drafters, particularly when the result will, in our view, mislead applicants.

The practical difficulty -- or actual impossibility -- of disclosing all the terms and conditions of these ancillary, optional lines of credit at the preapplication stage becomes obvious when viewed in the context of pending legislation. For example, Senator D'Amato's bill (S. 2264) would require card issuers to disclose "the annual percentage rate used to determine a finance charge on any balances." This disclosure must be made in any credit card application or solicitation. Similarly, legislation sponsored by Senator Dodd (S. 2140) would require card issuers to disclose "the annual percentage rate applicable to extensions of credit by means of that credit card or in the case of an extension of credit subject to a variable rate, the means of determining that rate" on either initial credit card applications or materials accompanying those applications.

Finally, Senator Gorton's S. 2421 would mandate the disclosure, in credit card solicitations or advertisements mailed to consumers, of "the annual percentage rate applicable to extensions of credit obtained by use of the credit card."

For example, application of the provisions of Senator Dodd's bill to the Gold Card line of credit product would result in the following disclosure:

S. 2140

"No finance charges are imposed for use of the card since all charges are due and payable upon receipt of the monthly statement; however, balances incurred on the line of credit offered by a participating depository institution may be subject to a variable annual rate of interest and grace periods. This rate may be computed in a variety of methods by different participating institutions."

We feel that such disclosure would be meaningless to the consumer.

In addition to the ancillary credit offered in connection with the Gold Card, we also offer the Sign & Travel Account to all Cardmembers, which permits them to defer certain prepaid travel packages on a limited basis. This feature is an optional ancillary benefit of Cardmembership, incidental to, but clearly separate from, the main function of the Card.

Consumers should not be deprived of the kind of straightforward disclosure they need to make informed decisions. Mr. Chairman, the mechanical and compliance problems we have raised concerning the pending legislation are not intended to detract from our belief in, or commitment to, complete disclosure of meaningful and comparable data. Specifically, we propose that these bills should be amended to recognize the distinctions between credit cards and charge cards and to require different and distinct disclosures on their respective applications.

We have drafted proposed amendments to the three bills which are designed to achieve these goals. Such tailored disclosures can help educate consumers about the relative costs of credit. These amendments would unquestionably avoid the problems inherent in the pending bills. Our amendments would require first that charge card applications emphasize that the outstanding balance is due and payable upon receipt of the bill. Customers would be less likely to misunderstand and assume that they can make partial payments as they can under credit card plans. Additionally, since the amendments would require disclosure of the annual fee for charge cards -- which are typically higher than credit card fees -- these disclosures will be very helpful to applicants. We urge the Subcommittee to require them on all charge card applications.

I'll be glad to answer any questions you may have.

Proposed Amendment to  
the Fair Credit Card Act of 1986  
(S. 2421, introduced by Senator Gorton on May 7, 1986)

Section 2 of S. 2421 is amended by adding the following at the end thereof:

"(e) The issuer of a charge card shall, in any card solicitation or advertisement mailed to the consumer clearly and conspicuously disclose -

- (1) any annual or other charge or fee, applicable to the issuance or renewal of the card; and
- (2) that charges incurred by use of the card are due and payable upon receipt of a periodic statement of charges.

For purposes of this subsection, the term "charge card" shall mean a credit plan under which a card issuer extends credit that is not subject to a finance charge. Issuers of charge cards shall make the disclosures required by this subsection rather than those required by subsection (c) even though the credit plan, in connection with which the charge card is issued, may include the right of a cardholder to obtain open-end credit, provided that such open-end credit is not automatically accessed through use of the card."

Proposed Amendment to  
the Credit Card Disclosure Act of 1986  
[S. 2264, introduced by Senator D'Amato on March 27, 1986]

Section 2 of S. 2264 is amended by adding the following at the end thereof:

"(d) The issuer of a charge card shall, in any application to open any card account, or in any solicitation which offers to open such an account without the need for an application to be completed, disclose in a clear and conspicuous manner -

- (1) any annual or other charge or fee applicable to the issuance or renewal of the card; and
- (2) that charges incurred by use of the card are due and payable upon receipt of a periodic statement of charges.

For purposes of this subsection, the term "charge card" shall mean a credit plan under which a card issuer extends credit that is not subject to a finance charge. Issuers of charge cards shall make the disclosures required by this subsection rather than those required by subsection (c) even though the credit plan, in connection with which the charge card is issued, may include the right of a cardholder to receive open-end credit, provided that such open-end credit is not automatically accessed through use of the card."

Proposed Amendment to S. 2140  
[Introduced by Senator Dodd on March 5, 1986]

Section 127 of the Truth in Lending Act (15 U.S.C. 1637) as amended by S. 2140 is amended by adding the following at the end thereof:

"(d) The issuer of a charge card shall clearly and conspicuously disclose either on initial applications for such card or on materials accompanying those applications -

- (1) any annual or other charge or fee applicable to the issuance or renewal of the card; and
- (2) that charges incurred by use of the card are due and payable upon receipt of a periodic statement of charges.

For purposes of this subsection, the term "charge card" shall mean a credit plan under which a card issuer extends credit that is not subject to a finance charge. Issuers of charge cards shall make the disclosures required by this subsection rather than those required by subsection (c) even though the credit plan, in connection with which the charge card is issued, may include the right of a cardholder to obtain open-end credit, provided that such open-end credit is not automatically accessed through use of the card."



Senator GORTON. Mr. Feldman, we'd like to hear from you now.

**STATEMENT OF SHELDON FELDMAN, ATTORNEY, REPRESENTING THE NATIONAL RETAIL MERCHANTS ASSOCIATION**

Mr. FELDMAN. Thank you, Mr. Chairman. I promise to be very brief.

I appear this morning as counsel to the National Retail Merchants Association. NRMA is the Nation's largest trade association for the general merchandise retailing industry. Its members comprise over 45,000 leading department, chain, independent, and specialty stores in all 50 States.

I will not take the time to go over some of the concerns that we have with regard to the solicitation disclosure requirement. These concerns are explained in our prepared statement. The bottom line is that NRMA will not oppose the adoption of legislation which would require a limited advance disclosure in written credit card solicitations.

We do have some suggestions that we feel would improve that aspect of the legislation and those proposed modifications appear in our prepared statement.

**LIMIT DISCLOSURE TO THREE KEY ITEMS**

To keep these advance disclosures as simple as possible, to facilitate making the disclosures, as well as their assimilation by consumers, they should be limited to the three key items of the nominal annual percentage rate, the grace period, and the annual fee.

The balance of my remarks will address the proposal to go beyond disclosure and require a change in credit card issuers' practices. NRMA's position is unequivocal. We do not believe that Congress should legislate the manner in which creditors impose finance charges, just as we do not believe that Congress should impose a ceiling on finance charge rates.

Even though this part of the legislation, as presently drafted, excludes retailers' credit card plans, and properly so, we are concerned that this provision might be extended to retailers in a misguided effort to treat all credit card issuers in the same way. If this were to take place, the resulting legislation would still be ill-conceived.

But in the case of retailers, where finance charge income is generally the only source of credit revenue, this would be rate-setting and economically unsound.

In addition, the proposal to mandate one uniform balance method would conflict with a vast body of State law and it would also impose significant burdens on small retailers.

**STATE STATUTES ARE ADEQUATE**

Balance calculation methods are currently regulated under State law. Excerpts of these statutes are attached to my statement, comprising just in brief part some 40 pages. We welcome your examination of these State statutes.

These State statutes deal with permissible balance methods, creditor remedies, the amount of authorized charges, and many of these statutes couple the balance method provisions with restric-

tions against imposing other fees, such as annual fees or late charges, and provisions mandating a grace period for avoidance of finance charges when there is no beginning balance in the account or if the balance is paid in full at the end of the billing cycle.

Congress should not interfere with this longstanding effort of the States to regulate creditors' practices and rates.

Turning to the burden on small retailers, many retailers do not have the operational capacity to use the average daily balance method, which requires sophisticated computer capability. Enactment of this proposal could require those creditors to either retain an outside service company, at significantly increased costs, or abandon their proprietary credit programs entirely.

The balance method is only one component of a credit card plan. Creditors should be free to combine their different balance methods with different rates and remedies, all of which are interdependent and affected by a broad range of variables.

Finally, let me add that we think there are also some disadvantages for consumers in this proposal. The requirement to discontinue the use of a particular balance method might compel some creditors to offset lost revenues by taking any one or more of a number of steps. For example, retailers may be forced to increase the rate of finance charge, reduce the availability of credit, or increase the cash price of goods, thus forcing all consumers to subsidize part of the cost of financing the credit card operation. None of this is in the consumer's best interests.

We appreciate the opportunity to appear this morning.

[The complete prepared statement follows:]

National Retail Merchants Association  
TELEPHONE: 212-361-1240  
FAX: 212-361-1240  
ATTN: NRMA



STATEMENT OF

SHELDON FELDMAN  
WASHINGTON COUNSEL  
WEIL, GOTSHAL & MANGES

ON BEHALF OF

NATIONAL RETAIL MERCHANTS ASSOCIATION

ON

S.2140; CREDIT CARD DISCLOSURE ACT OF 1986 (S. 2264);  
AND  
FAIR CREDIT CARD ACT OF 1986 (S. 2421)

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
U.S. SENATE

MAY 21, 1986

Mr. Chairman, members of the Subcommittee, I am Sheldon Feldman, of the law firm of Weil, Gotshal & Manges, counsel to the National Retail Merchants Association ("NRMA"). NRMA welcomes the opportunity to present the views of retailing on S. 2140, S. 2264, and S. 2421, proposed legislation to require certain disclosures in credit card solicitations and, in the case of S. 2421, to mandate a uniform balance method calculation for third-party credit card issuers.

NRMA is the nation's largest trade association for the general merchandise retailing industry. Its members operate 45,000 leading department, chain, independent and specialty stores in all 50 states. NRMA members' annual sales exceed \$150 billion, although the vast majority of NRMA's members are small, independent retailers whose annual sales are less than \$1 million. Virtually all of NRMA's members extend credit by issuing their own credit cards or by accepting third-party credit cards. For this reason, these hearings are of great importance to the retail industry.

The Proposed Legislation

S. 2140 would amend the Truth-in-Lending Act to require a card issuer to disclose on initial applications (1) the annual percentage rate, (2) any fee for issuance of the card, (3) the period for avoidance of finance charge, if any, and (4) a statement of how the creditor determines the balance on which the finance charge is computed.

S. 2264, the Credit Card Disclosure Act of 1986, would require that any credit card application or solicitation disclose the same information prescribed in S. 2140, except in S. 2264 disclosure of any minimum or fixed finance charge is substituted for disclosure of the balance method. S. 2264 also would require credit card issuers to submit to the Federal Reserve Board quarterly reports showing their annual percentage rates, grace periods, minimum finance charges, and annual fees, so that the Board could make such information available to the public upon request and in its annual report to Congress.

S. 2421 would amend the Truth-in-Lending Act to require that "credit card solicitations or advertisements" mailed to the consumer disclose (1) the annual percentage rate, (2) the conditions under which a finance charge is imposed, including the time period within which any credit extended may be repaid without incurring a finance charge or, if no such time period is provided, disclosure of that fact, and (3) the amount of annual fees or other charges.

S. 2421 also would require the Federal Reserve Board to promulgate regulations to mandate, for third-party credit card issuers, adoption of the average daily balance method of calculating finance charges, or some other method which would yield lower finance charges.

The basic goal of the disclosure provisions of these bills is to address the perceived problem of consumers being unaware of credit costs before they become contractually liable or receive their credit card. The proposed solution is to provide information to consumers about the cost of a credit card plan before the consumer responds to that solicitation. At present, the Truth-in-Lending Act requires full cost of credit disclosure before the first transaction is made under the credit card plan, but a credit card issuer is not required to disclose key information, such as the rate of finance charge or the amount of the annual fee, until after the consumer requests the credit card.

#### Credit Card Solicitation Disclosures

NRMA believes that the need to require retailers to provide additional credit disclosures to their credit card customers has not been determined. First, the majority of retailers' accounts are opened through applications made available to customers in the stores, generally called "take-one" applications. These applications are usually accompanied by the entire account agreement, which contains all Truth-in-Lending disclosures, including cost of credit information. Even when that is not the case, retailers do not impose annual fees (such fees are not permitted in many states), one of the two key items of information (the other being the annual percentage rate) that proponents of these bills argue is unfairly withheld from such solicitations. As a result, applicants for retail credit cards receive all cost of credit disclosures pursuant to existing federal law, before they incur any charges on the account.

Moreover, imposing an advance disclosure requirement could impose compliance problems for retailers. Unlike financial institutions, which often utilize a single or uniform rate structure under the law of their home state, retailers' rates and other terms are governed by the laws of the state of the customer's residence. As a consequence, under these bills national and multi-state retailers would be forced to incorporate their entire finance charge rate chart

and, under S. 2140, all variations in balance methods, into their credit card solicitations.

In spite of our belief that advance disclosures are not needed, NRMA will not oppose the adoption of legislation which would require limited advance disclosure in written credit card solicitations. Retailing is willing to accept the additional burden incident to complying with an advance disclosure requirement, if Congress deems it necessary to protect the public from uninformed credit decisions. Thus, we would not oppose adoption of the disclosure requirements found in S. 2421, because the disclosure component of that bill would impose fewer compliance burdens, while encompassing disclosure of the basic information (i.e., the rate, grace period and annual fee) that proponents of these bills believe consumers should have.

There are, however, certain modifications that we recommend. First, the bill should be clarified by deleting the words "or advertisements." Since the bill is intended to require advance disclosure only in written "solicitations" for new credit card accounts, and different rules already exist for disclosure of terms in certain credit card "advertisements" (i.e., see Section 143 of the Truth-in-Lending Act, which is implemented by § 226.16 of Regulation Z), the presence of the words "or advertisements" adds an unnecessary element of uncertainty to the scope of this legislation. Read literally, this language could be construed as requiring advance cost of credit disclosure in any "credit card . . . advertisement(s)," arguably including those advertisements for goods or services which merely state or imply that the goods or services can be charged to the advertiser's credit card account. While we are certain that this is not the intent of the legislation, this ambiguity should be removed.

The second modification we recommend is deletion of the language "and other charges." The annual fee is the only significant charge that is imposed upon consumers for the privilege of obtaining the credit card. Other charges, such as late fees and returned check charges, are a consequence of default and not a charge for the use of the credit card. In any case, these charges will be disclosed in the account agreement before the card is used. Thus, to keep these advance disclosures as simple as possible, to facilitate making the disclosures, as well as their assimilation by consumers, they should be limited to the three key items of

the nominal annual percentage rate, the grace period, and the annual fee.

There are other modifications which we believe would improve the disclosure requirement, without detracting from its basic purpose. For example, we suggest that the bill provide that creditors may satisfy the disclosure requirement by including a copy of their credit agreement. Rather than spell out these recommendations here, we would be happy to assist the Subcommittee in developing legislation that is workable but still provides consumers with meaningful disclosure.

The balance of our statement will address a proposal to go beyond disclosure and require a change in credit card issuers' practices.

#### Balance Method Regulation

Turning to the second component of S. 2421, NRMA's position is unequivocal. We do not believe that Congress should legislate the manner in which creditors impose finance charges, just as we do not believe that Congress should impose a ceiling on finance charge rates. Even though this part of the legislation, as presently drafted, excludes retailers' credit card plans, and properly so, we are concerned that this provision might be extended to retailers in a misguided effort to treat all credit card issuers in the same way. If this were to take place, the resulting legislation would still be ill-conceived. In the case of retailers, finance charge income is generally the only source of credit revenue, and since this aspect of the legislation is a form of rate-setting, there is no economic justification for such a measure.

Retailing opposes legislation which would mandate one uniform balance method or a method which results in the imposition of less finance charges, on more than economic grounds. This provision would not only conflict with a vast body of state law, it would impose significant burdens on many retailers. These concerns, and other reasons for our opposition, are explained briefly below.

Conflict With State Law - Balance calculation methods are currently regulated under state law (Retail Installment Sales Acts, or Uniform Consumer Credit Codes) in virtually all states. These statutes, which are set forth in pertinent part in Appendix A to this statement, represent a

careful effort on the part of state legislatures to balance the regulation of permissible balance methods with rates, creditor remedies, the amount of other authorized charges, etc. Pursuant to this integrated legislation, some states expressly authorize the average daily balance method, but require exclusion of current purchases in calculating the daily balance, while other states authorize inclusion of current purchases in the daily balance. At least one state prohibits the average daily balance method entirely. A significant number of other states authorize a method other than average daily balance, such as the previous balance method. Many of these states couple their balance method provisions with restrictions against imposing other fees, such as annual fees or late charges. Indeed, in recent months a number of states have further restricted retailers by enacting legislation prohibiting merchants from adding a surcharge to the price of goods if a consumer chooses to purchase those goods with a credit card. Many states couple the regulation of retailers' balance method with provisions mandating a grace period for avoidance of finance charges when there is no beginning balance in the account or if the balance is paid in full at the end of the billing cycle. Congress should not interfere with this long-standing effort of the states to regulate creditors' practices and rates.

Burden On Small Retailers - Some small retailers do not have the operational capacity to use the average daily balance method, which requires sophisticated computer capability. Enactment of this proposal could require those creditors to retain an outside service company, at significant increased cost, or abandon their proprietary credit programs entirely. Also, retailers whose balance method will change by virtue of this legislation would be required to reprint all of their account agreements and, in many cases, their periodic statements as well, because under federal and state law those forms must disclose the balance computation method. Moreover, these retailers would be required to provide a notice of change in terms to all existing customers, because this is required under federal law when a previously disclosed term, such as the balance method, is changed. The costs of making these changes and providing these notices could be staggering.

Federal Regulation Of Terms Has Been Considered And Rejected - Congress has in the past considered regulating creditors' practices, such as mandating a "free-ride," prescribing a particular balance method, etc., and has consistently chosen to require disclosure rather than

requiring uniformity of credit terms and practices. Diversity of practices and credit terms, coupled with full disclosure, encourages innovation, and competition, and leaves the consumer free to choose between competing creditors' plans.

The Balance Method Is Only One Component Of A Credit Card Plan - Creditors should be free to combine their different balance methods with different rates and remedies, all of which are interdependent and affected by a broad range of variables. The retailer's decision as to which balance method to select may be dictated by the profit margin on the goods sold, the frequency of repetitive transactions, the proportion of total customers who pay in full each month, the average dollar amount of outstanding account balance, the level of acceptable risk, whether other remedies, such as security interests, are available, and other factors, alone or in combination with those mentioned. The balance method is only one component of a multi-faceted system, all of which are interdependent, and regulated as an integrated unit by state law, and restricting it could adversely impact upon the retailer's entire credit card program.

Disadvantages For Consumers - The requirement to discontinue use of a balance method may compel some creditors to offset lost revenues by taking any one or more of a number of steps. For example, retailers may be forced to increase the rate of finance charge, reduce the availability of credit, or increase the cash price of goods, thus forcing all consumers to subsidize part of the cost of financing the credit card operation. None of this is in consumers' best interests. Moreover, if the object is to eliminate variations in credit card plans, except for the creditor's rate, to facilitate shopping for credit, this proposal will not accomplish that goal. Therefore, we believe that the proposal is totally unsound and economically unjustified.

NRMA appreciates the opportunity to present the views of retailing on these important subjects and I would be happy to respond to any questions you may have.



## APPENDIX A

## TO THE STATEMENT OF

## NATIONAL RETAIL MERCHANTS ASSOCIATION

State Statutory Provisions -  
Open-End Credit - Balance Method Computation

Note: the following provisions are reprinted with permission from CCH Consumer Credit Guide and should be used for background information only. Only the official statutory texts should be relied upon for assurance of accuracy and completeness. Only provisions relating to balance method computation appear below. Additional provisions relating to grace periods, limitations on other charges, etc., may exist and do not appear below.

## ALABAMA

[§ 6002]

## Sec. 5-19-3. Maximum finance charges—Contracting for minimum finance charge.

(a) The maximum finance charge for any loan or forbearance and for any credit sale, except under open end credit plans, may equal but may not exceed the total of the following: (1) \$15 per \$100 per year for the first \$750 of the original principal amount of the loan or amount financed; and (2) \$10 per \$100 per year for that portion of the original principal amount of the loan or original amount financed exceeding \$750 and not exceeding \$2,000; and (3) \$8 per \$100 per year for that portion of the original principal amount of the loan or original amount financed exceeding \$2,000. (b) The maximum finance charge under subsection (a) of this section shall be determined by computing the maximum rates authorized by subsection (a) of this section on the original principal amount of the loan or original amount financed for the full term of the contract without regard to scheduled payments and the maximum finance charge so determined, or any lesser amount, may be added to the original principal amount of the loan or original amount financed. (c) If the debt is created under an open end credit plan, the maximum finance charge in connection therewith shall be one and one-half percent (1½%) per month on the unpaid balance from time to time thereunder. (d) A creditor, in connection with any credit sale other than a sale made under an open end credit plan, may contract for and receive a minimum finance charge not in excess of the following amounts: (1) \$4.00 on any credit sale in which the amount financed is \$25.00 or less; and (2) \$6.00 on any credit sale in which the amount financed is

more than \$25.00. (e) On an open end credit plan, if there is an unpaid balance on the date as of which the finance charge is applied, a creditor may contract for and receive a minimum finance charge in an amount computed at a rate not exceeding \$30 per month. (f) In lieu of the finance charges set forth in subsection (a), other than under an open-end credit plan, a creditor may contract for and receive finance charges on any loan of money at the rate of not more than one and one-half percent (1½%) per month as follows: (1) Charges shall be computed on unpaid balances of the principal amount outstanding from time to time, for the actual time outstanding. Each payment shall be applied first to accumulated charges and the remainder of the payment applied to the unpaid principal balance, except that if the amount of the

payment is insufficient to pay the accumulated charges, unpaid charges continue to accumulate to be paid from the proceeds of subsequent payments and are not added to the principal balance. (2) Creditors shall not make charges under this subsection payable in advance, nor may charges be compounded; however, if part or all of the consideration for a new loan contract is the unpaid principal balance of a prior loan, then the principal amount payable under such new loan contract may include any unpaid charges which have accrued. The resulting loan contract shall be deemed a new and separate loan transaction for all purposes. The principal balance of a loan on which charges have been made pursuant to subsection (a) of this section shall be the balance due after refund or credit is given to the borrower. Borrowers under this subsection may pay in advance the principal balance, including any charges, of a loan contract without penalty. For purposes of computing charges for a fraction of a month, a day shall be considered one-thirtieth of a month. (g) The provisions of Section 5-19-4 shall not apply to loans made under subsection (f) of this section. [Comp. as § 4131, 4161, 4171, 4172.] [Sec. 5-19-3, as amended by Laws 1979, Ch. 328, approved and effective July 12, 1979.]

## ALASKA

## [§ 6012]

## Sec. 45.10.120. Extent of service charge.

(a) The service charge shall include all charges incident to investigating and making the retail installment contract or charge agreement and for the privilege of making the installment payments under the contract or agreement. No other fee, expense, or charge may be taken, received, reserved, or contracted for investigating and making the contract or agreement, or for the privilege of making the payments.

(b) A seller or holder of a retail installment contract may charge, receive and collect a service charge which shall not exceed the following rates multiplied by the number of months, including fraction of a month in excess of 15 days as one month, elapsing between the date of the contract and the due date of the last installment.

(1) on so much of the unpaid balance as does not exceed \$1,000, five-sixths of one per cent;

(2) if the unpaid balance exceeds \$1,000, on so much of the unpaid balance as exceeds \$1,000, two-thirds of one per cent;

(3) if the total service charge so computed is less than \$12, \$12, but if the due date of the last installment of the contract is eight months or less after its effective date, \$10.

(c) A seller or holder of a retail charge agreement, revolving charge agreement or other retail charge agreement may charge, receive and collect a service charge not to exceed the following rates computed on the outstanding balances from month to month.

(1) on so much of the outstanding balance as does not exceed \$1,000, one and one-half per cent per month;

(2) if the outstanding balance is more than \$1,000, one-twelfth of the annual rate permitted under AS 45.010(b) [§ 6401] per month on the excess over \$1,000 of the outstanding balance;

(3) if the service charge so computed is less than \$1 for any month, \$1;

(4) the service charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amount minus a differential of not more than \$5 provided that it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential. Comp. at § 4151, 4171, 4540.]

[Sec. 45.10.120, as amended by Laws 1966, Ch. 154, approved May 11, 1966, effective August 9, 1966; Laws 1980, Ch. 79, approved June 12, 1980, effective September 10, 1980.]

01 1980 Amendment.—The amendment changed, in sub. (c)(2), "one per cent per month on the excess over \$1,000" to "one-twelfth of the annual rate permitted under AS 45.010(b) per month on the excess over \$1,000"—CCH.

## ARIZONA

[§ 6126]

Sec. 44-6002 (contd.). [Retail charge account agreements—Minimum finance charge.] E. Under a retail charge account agreement a rate of finance charge not to exceed the maximum rate set by contract may be charged and received on an amount not in excess of the greatest of any of the following:

1. The average daily balance in the account in the billing cycle period.
2. The balance in the account at the beginning of the billing cycle period, after first deducting payments and credits received during that billing cycle period.
3. The median amount within a ten dollar range in which the balance as computed under paragraph 1 or 2 of this subsection falls if the seller applies the same finance charge to all such balances within such range.

F. As used in this section, month need not be a calendar month but may, instead, be a regular billing cycle period. If the finance charge for the billing cycle period is less than fifty cents, a minimum finance charge not in excess of fifty cents may be charged for the period. [Comp. at § 4171.]

[Sec. 44-6002E and F, as added by Laws 1980, Ch. 200, approved and effective April 23, 1980.]

## ARKANSAS

No Provision Located

## CALIFORNIA

[§ 6066]

—Effective until January 1, 1988—

**Sec. 1810.2. [Finance charge limitations—Retail installment accounts.]** Subject to the other provisions of this article, the seller or holder of a retail installment account may charge, receive and collect the finance charge authorized by this chapter. The finance charge shall not exceed the following rates computed on the outstanding balances from month to month:

(a) On so much of the outstanding balance as does not exceed three thousand dollars (\$3,000), 1½ percent.

(b) If the outstanding balance is more than three thousand dollars (\$3,000), 1 percent on the excess over three thousand dollars (\$3,000) of the outstanding balance.

(c) If the finance charge so computed is less than one dollar (\$1) for any month, one dollar (\$1).

(d) The finance charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amounts minus a differential of not more than five dollars (\$5), provided it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential.

This section shall remain in effect only until January 1, 1988, and as of that date is repealed. [Comp. at § 4171.]

[Sec. 1810.2, as amended by Laws 1980, Ch. 26; Laws 1982, Ch. 1614; Laws 1983, Ch. 1157; Laws 1985, Ch. 227, approved July 15, 1985, effective January 1, 1986.]

**01 1985 Amendment.**—The amendment changed the repeal date from January 1, 1986 to January 1, 1988.—CCH.

—Effective January 1, 1988—

**Sec. 1810.2. [Finance charge rate limitations—Retail installment accounts.]** Subject to the other provisions of this article, the seller or holder of a retail installment account may charge, receive and collect the finance charge authorized by this chapter. The finance charge shall not exceed the following rates computed on the outstanding balances from month to month:

(a) On so much of the outstanding balance as does not exceed one thousand dollars (\$1,000), 1½ percent.

(b) If the outstanding balance is more than one thousand dollars (\$1,000), 1 per-

cent on the excess over one thousand dollars (\$1,000) of the outstanding balance.

(c) If the finance charge so computed is less than one dollar (\$1) for any month, one dollar (\$1).

(d) The finance charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amounts minus a differential of not more than five dollars (\$5), provided that it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential.

This section shall become operative on January 1, 1988. [Comp. at § 4171.]

[Sec. 1810.2, as amended by Laws 1980, Ch. 26; Laws 1982, Ch. 1161; Laws 1983, Ch. 1157; Laws 1985, Ch. 227, approved July 15, 1985, effective January 1, 1986.]

**01 1985 Amendment.**—The amendment changed the operative date from January 1, 1986 to January 1, 1988.—CCH.

**59 Previous balance method.**—The use of the "previous balance" method of finance charge calculation on retail installment accounts is permissible under and not in violation of the charge limitation provisions of the retail installment sales law. Civil Code Section 1810.2.—*Siebert v. Sears, Roebuck & Co.* (Cal. Super. Ct. 1972); CCH CONSUMER CREDIT GUIDE § 99.164.

Use of the previous balance method in computing finance charges does not violate state law. Although, as contended, other

methods might produce results more favorable to the consumer, there is nothing in the statutory language prohibiting use of the method at issue. Furthermore, the court noted that the legislative history of the law does not show any intent to prohibit the previous balance method, even though it was widely used, and is widely used.—*Siebert v. Sears, Roebuck and Co.* (Cal. Ct. App. 1975) CCH CONSUMER CREDIT GUIDE § 98.650, 45 C. A. 3d.

## COLORADO

## [§ 5067] Credit Service Charge for Revolving Charge Accounts

Sec. 2.207. (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

- (a) the average daily balance of the account,
- (b) the unpaid balance of the account on the same day of the billing cycle, or
- (c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8 per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and  $1\frac{1}{2}$  per cent on that part of this amount which is more than \$500. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the same day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) The amounts of \$500 in subsection (3) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

Colorado. Subsection (2) reads as follows: "(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than the average daily balance of the account in the billing cycle for which the charge is made, which is the sum of the amount unpaid each day during that cycle, divided by the number of days in that cycle; the amount unpaid on a day is determined by adding to any balance unpaid as of the beginning of that day all purchases and other debits and deducting all payments and other credits made or received as of that day."

In subsection (3), after "exceed" substitute "one and three-quarters percent of the amount" for "2 per cent of that part of the amount" and add "of this section".

Subsection (5) reads as follows: "(5) The parties may contract to use any method of determining the amount to which the rate of credit service charge is applied if the amount so determined does not exceed the amount permitted in subsection (2) of this section."

[Sec. 5-2-207, as amended by Laws 1975, H. B. 1349, Laws 1981, H. B. 1585, approved and effective June 8, 1981]

## CONNECTICUT

## [§ 4137]

Sec. 42-133c. Maximum finance charge on open-end credit plans. Notwithstanding any contrary provision of law, the maximum finance charge which may be applied under an open-end credit plan, as defined in subdivision (h) of section 36-393 [§ 4161], in connection with a transaction arising out of a retail sale of consumer goods or services shall not exceed one and one-half per cent per month, (1) on sales made on or after July 1, 1981 and prior to October 1, 1987, and one and one-quarter per cent per month, (2) on sales made on or after October 1, 1987, on the average daily balance of the account or the unpaid balance outstanding as of the end of the current billing cycle. Regardless of any agreement to the contrary, a transaction under an open-end credit plan is subject to this section whenever a solicitation for the extension of credit is made by a creditor whose primary activity in Connecticut is soliciting Connecticut customers through the mails, and

such solicitation originates outside Connecticut but is directed to and received by a customer who resides, and responds to such solicitation, in Connecticut. [Comp. at § 4171, 4172.] [Sec. 42-133c, as amended by Laws 1977, P. A. 77-391; Laws 1979, P. A. 79-127; Laws 1980, P. A. 80-69 and P. A. 80-483; Laws 1981, P. A. 81-362; Laws 1982, P. A. 82-105; Laws

1983, P. A. 83-226; Laws 1985, P. A. 522, approved July 2, 1985, effective October 1, 1985.]

01 1985 Amendment.—The amendment changed the applicable date for the 1½% rate from "prior to October 1, 1985" to "prior to October 1, 1987," and for the 1¼% rate, for "sales made on or after October 1, 1985" to "sales made on or after October 1, 1987."—CCH.

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## DELAWARE

## [§ 6937]

Sec. 4337. Service charge. Subject to the other provisions of this subchapter a retail seller or the holder of a retail installment account may charge and collect a service charge computed on the outstanding unpaid indebtedness in a buyer's retail installment account and may calculate such service charge in the manner and at such daily, weekly, monthly, annual or other periodic percentage rate or rates as the agreement governing retail installment account provided, however, that if the service charge as so computed is less than one dollar for any month, the holder may charge one dollar as a service charge for such month. If the applicable periodic percentage rate under the agreement governing a retail installment account is other than daily, the service charge may be calculated on an amount not in excess of the average of outstanding unpaid indebtedness for the applicable billing period, determined by dividing the total of the amounts of outstanding unpaid indebtedness for each day in the applicable billing period by the number of days in the billing period. If the applicable periodic percentage rate under the agreement governing the retail installment account is monthly, a billing period shall be deemed to be a month or monthly if the last day of each billing period is on the same day of each month or does not vary by more than four days therefrom. [Comp. at § 4171.]

[Sec. 4337, as amended by Laws 1980, Ch. 228; Laws 1981, Ch. 2, approved February 18, 1981, effective June 1, 1981.]



## DISTRICT OF COLUMBIA

## [Y 6131]

Sec. 28-3701. **Definitions.** As used in this chapter—(1) "revolving credit account" means an arrangement between a seller or financial institution and a buyer pursuant to which (A) the seller may permit the buyer to purchase goods or services from time to time, either directly from the seller or by use of a credit card or other device, whether issued by the seller or a financial institution, (B) the unpaid balances of amounts financed arising from purchases and the credit service and other appropriate charges are debited to an account, (C) a credit service charge if made is not precomputed but is computed on an outstanding unpaid balance of the buyer's account from time to time, and (D) the buyer has the privilege of paying the balances in full or in installments. The term "revolving credit account" shall not include loans obtained by a person from a financial institution where a check, credit card, or other device is used to access a line of credit.

## [Y 6132]

Sec. 28-3702. **Amount and computation of credit service charge.** (a) The seller or financial institution may contract for the payment by the buyer of a credit service charge not exceeding that permitted by this section.

(b) A credit service charge may be made in each billing cycle. For the purpose of computing the outstanding balance subject to the credit service charge, (1) the outstanding balance on any day shall consist of an amount which shall not exceed the sum of the total charges to the account less the amounts paid or credited to the account prior to such day, or (2) the outstanding balance may be computed by the average daily balance method. The credit service charge may also be computed for all outstanding balances within a range of not in excess of \$10 on the basis of the median amount within such range if as so computed such credit service charge is applied to all outstanding balance within such range.

## FLORIDA

(3) Notwithstanding the provisions of any other law, the seller under a revolving account may charge, receive, and collect, a finance charge which may not exceed 15 cents per \$10 per month, computed on all amounts unpaid thereunder from month to month (which need not be a calendar month) or other regular period, and a delinquency charge not to exceed 5 percent of each payment in default for a period of not less than 10 days, or \$5, whichever is less, provided that any such charge is agreed upon, in writing, between the parties prior to imposing any such charge; however, if the amount of the delinquency charge so computed is less than \$1 for any such period, no delinquency charge may be assessed for that period. If the amount of the finance charge so computed shall be less than \$1 for any such month, a finance charge of \$1 for any such month may be charged, received, and collected. If the regular period is other than such monthly period or if the unpaid amount is less than or greater than \$3, the permitted finance charge shall be computed proportionately. Such finance charge may be computed for all unpaid balances within a range of not in excess of \$10 on the basis of the median amount within such range, if as so computed such finance charge is applied to all unpaid balances within such range. [Comp. at ¶ 4043, 4062, 4110, 4171.]

[Sec. 520.35, as amended by Laws 1984, Ch. 84-180.]

45. Legality of "previous balance" method.—The "previous balance" method of determining the finance charge on a revolving charge account was not contrary to Florida law [Sec. 520.35].—*Federal Dept. Stores, Inc. v. Penco; Sears, Roebuck & Co.*

*v. Hicks; City Stores Co. v. Unger; Byrnes Department Store, Inc. v. Brockington; Jandam Marsh Co. v. Williams* (Fla. Dist. Ct. of App. 1973) CCH CONSUMER CREDIT GUIDE ¶ 99,039, 275 So. 2d 46.

## GEORGIA

## [§ 6113]

Sec. 10-1-4 (contd.). [Time price differential on revolving account.] (b) Notwithstanding the provisions of any other law, the seller under a revolving account may charge, receive and collect, a time price differential which shall not exceed 17 1/2¢ per \$10.00 per month computed on all amounts unpaid thereunder from month to month (which need not be a calendar month) or other regular period. If the amount of the time price differential so computed shall be less than \$1.00 for any such month, a time price differential of \$1.00 for any such month may be charged, received and collected. If the regular period is other than such monthly period or if the unpaid amount is less than or greater than \$3.00, the permitted time price differential shall be computed proportionately. Such time price differential may be computed for all unpaid balances within a range of not in excess of \$10.00 on the basis of the median amount within such range if as so computed such time price differential is applied to all unpaid balances within such range. [Comp. at § 4171, 4540.]

## HAWAII

[§ 6046]

Sec. 478-26. Regulation of finance charges. It shall be unlawful, directly or indirectly, to charge, contract for, collect, or receive any finance charge, on a credit sale contract except as is provided by this section.

(1) If the finance charge is stated as a dollar amount and is added on or deducted in advance, and the buyer promises to pay a fixed total of payments, the finance charge shall not exceed the amount of interest or discount which could lawfully be added on or deducted in advance by an industrial loan company under chapter 408 on a loan to run for the same period as the credit sale contract, where the actual cash received by the borrower would be equal in amount to the principal balance of the credit sale contract, provided that a minimum finance charge of not more than \$10 shall be allowable in a credit sale when the finance charge is stated in a dollar amount. Upon maturity of a contract, the rate of finance charge on the unpaid principal balance of the contract shall be eighteen per cent a year, unless a lesser rate for after maturity finance charge is specified in the contract.

(2) As an alternative to the finance charge authorized by paragraph (1), a seller may contract for and receive a finance charge at a rate not exceeding twenty-four per cent a year on the principal balance remaining unpaid from time to time under the contract, whether or not the rate of the finance charge under the contract is fixed or variable. Upon maturity of a contract, the rate of finance charge on the unpaid principal balance of the contract may be twelve per cent a year, the original contract rate of finance charge or, in the case of any extension or deferral, the rate of finance charge permitted by this chapter on the amount extended or deferred, whichever is greatest. [Comp. at § 4151.]

IDAHO

**[§ 5067] Credit Service Charge for Revolving Charge Accounts**

**Sec. 2.207.** (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

- (a) the average daily balance of the account,
- (b) the unpaid balance of the account on the same day of the billing cycle, or

(c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8 per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and 1½ per cent on that part of this amount which is more than \$500. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the same day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) The amounts of \$300 in subsection (3) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

Consumer Credit Guide

1969 UCCC § 2.207 § 5067

## ILLINOIS

[T 6042]

✓ Sec. 28. (Rev. Stat. 12194 § 528.) (a) Retail charge agreements—Rates. Notwithstanding the provisions of any other statute, a retail charge agreement may provide for, and the seller or holder may, if the agreement does so provide, charge, collect and receive, a finance charge not exceeding 18¢ per \$10 per month, computed on all amounts unpaid thereunder from month to month, which need not be a calendar month. The finance charge under this Section may be computed for all unpaid balances from month to month within a range of not exceeding \$10 on the basis of the median amount within the range if, as so computed, the same rate of finance charge is applied to all unpaid balances within the range. If the amount of the finance charge as so computed is less than 70¢ for any month, a finance charge of that amount may be charged, collected and received for that month. If the regular period is other than a month to month period, the finance charge shall be computed proportionately. and a

.61 Previous balance method.—The previous balance method of computing finance charges does consist of computing charges on all amounts unpaid from month to month and so is consistent with the requirements of the Retail Installment Sales Act—*Johnson v. Sears Roebuck & Co.*; *Brown v. Marcor, Inc.* (Ill. App. Ct. 1973) CCH CONSUMER CREDIT GUIDE ¶ 98,920, 303 N. E. 2d 640.

## INDIANA

## [§ 5067] Credit Service Charge for Revolving Charge Accounts

Sec. 2.207. (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

- (a) the average daily balance of the account,
- (b) the unpaid balance of the account on the same day of the billing cycle, or
- (c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8 per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and 1½ per cent on that part of this amount which is more than \$500. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the same day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) The amounts of \$500 in subsection (3) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

**Indiana.** In subsection (3) after "exceed" substitute "1½ per cent of the amount" for "1½ per cent of that part of the amount". After "subsection (2)" delete "which is \$500 or less and 1½ per cent on that part of this amount which is more than \$500". Omit subsection (5).

[Sec. 24-4.5-2-207, as amended by Laws 1981, P. L. 219; Laws 1982, S. B. 238, ap-

*proved February 24, 1982, effective September 1, 1982.] [NOTE: Until the September 1, 1982 effective date of the amendment, the former interest rate of 1½% is in effect. —CCH.]*



## IOWA

## [§ 5062]

Sec. 537.2202. Finance charge for consumer credit sales pursuant to open end credit. 1. With respect to a consumer credit sale made pursuant to open end credit, a creditor may contract for and receive a finance charge not exceeding that permitted in this section.

2. For each billing cycle, a charge may be made which is a percentage of an amount not exceeding the greatest of the following:

a. The average daily balance of the open end account in the billing cycle for which the charge is made, which is the sum of the amount unpaid each day during that cycle, divided by the number of days in that cycle. The amount unpaid on a day is determined by adding to the balance, if any, unpaid as of the beginning of that day all purchases and other debits and deducting all payments and other credits made or received as of that day.

b. The balance of the open end account at the beginning of the first day of the billing cycle, after deducting all payments and credits made in the cycle except credits

attributable to purchases charged to the account during the cycle.

c. The median amount within a specified range including the balance of the open end account not exceeding that permitted by paragraph "a" or "b". A charge may be made pursuant to this paragraph only if the creditor, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than eight percent of the charge on the median amount.

3. If the billing cycle is monthly, the charge may not exceed an amount equal to one point sixty-five percent. If the billing cycle is not monthly, the maximum charge for the billing cycle shall bear the same relation to the applicable monthly maximum charge as the number of days in the billing cycle bears to three hundred sixty-five divided by twelve. A billing cycle is monthly if the closing date of the cycle is the same date each month or does not vary by more than four days from the regular date.

4. If the charge determined pursuant to subsection 3 is less than fifty cents, a charge may be made which does not exceed fifty cents if the billing cycle is monthly or longer, or the pro rata part of fifty cents which bears the same relation to fifty cents as the number of days in the billing cycle bears to three hundred sixty-five divided by twelve if the billing cycle is shorter than monthly. [Comp. at § 4171.]

[Sec. 537.2202, as amended by Laws 1984, S. B. 2366, approved May 8, 1984, effective July 1, 1984.]

.01 1984 Amendment.—The amendment changed the first sentence of subsection 3, which read: "If the billing cycle is monthly, the charge may not exceed an amount equal to one and one-half percent of that part of the maximum amount pursuant to subsection 2 which is five hundred dollars or less and one and one-fourth percent of that part of the maximum amount which is more than five hundred dollars."—CCH.

## KANSAS

## [§ 5052]

Sec. 16a-2 22. Finance charge for consumer credit sales pursuant to open end credit. (1) With respect to a consumer credit sale made pursuant to open end credit, the parties to the sale may contract for the payment by the buyer of a finance charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than:

(a) the average daily balance of the account, which is the sum of the actual amounts outstanding each day during the billing cycle divided by the number of days in the cycle;

(b) the unpaid balance of the account on the last day of the billing cycle; or

(c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the last day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations the seller may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8% of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 1.75% of that part of the amount pursuant to subsection (2)

which is \$300 or less and 1.5% on that part of this amount which is more than \$300 but not more than \$1,000 and 1.2% on that part of this amount which is more than \$1,000. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the last day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding \$.50 if the billing cycle is monthly or longer, or the pro rata part of \$.50 which bears the same relation to \$.50 as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) As an alternative to the rates set forth in subsection (3), during the period beginning on the effective date of this act and ending July 1, 1987, the parties to the sale may contract for and the seller may receive a finance charge not exceeding 21% per year on the amount determined pursuant to subsection (2). [Comp. at § 4171.]

[Sec. 16a-2-202, as amended by Laws 1980, S. B. 896; Laws 1981, H. B. 2578; Laws 1982, S. B. 595; Laws 1983, H. B. 2079; Laws 1985, S. B. 123, approved April 16, 1985, effective upon publication in statute book.]

.01 1985 Amendment.—The amendment changed the date in paragraph (5) to 1987 from 1985.—CCH.

## KENTUCKY

No Provision Located

## LOUISIANA

[§ 5036]

Sec. 9:3523. Credit service charge for revolving charge accounts. On a revolving charge account, the extender of credit, issuer of a seller credit card honored by the extender of credit, or their assignee, may charge and collect a credit service charge in each billing period at a rate

(1) not in excess of one and one-half per cent per month computed on (a) the average daily balance of the account or (b) the balance of the account on the first day of each billing period without regard to transactions affecting the account during the billing period; provided, however, that a minimum credit service charge not in excess of fifty cents per month may be charged and collected; and provided further that no credit service charge shall be charged unless the bill is mailed no later than ten days (Saturdays, Sundays and legal holidays excluded) after the billing date stated on the bill; or

(2) any other method of computation which would not yield a greater credit service charge than Subsection (1) of this section. [Comp. at § 4171, 4640.]

## MAINE

[§ 5062]

Sec. 2-202. Finance charge for consumer credit sales pursuant to open-end credit. 1. With respect to a consumer credit sale made pursuant to open-end credit, a creditor may contract for and receive a finance charge not exceeding that permitted in this section.

2. A charge may be made in each billing cycle which is a percentage of an amount not exceeding the greater of:

A. The average daily balance in the billing cycle for which the charge is made, which is the sum of the amount unpaid each day during that cycle, divided by the number of days in that cycle. The amount unpaid on a day is determined by adding to the balance, if any, unpaid as of the beginning of that day all debits, but excluding all purchases or leases of goods and services made on that day and deducting all payments and other credits made or received as of that day; or

B. The unpaid balance at the beginning of the first day of the billing cycle after all payments on account, returns and other credits made or given during the first 25 days of the billing cycle, if the billing cycle is monthly, shall have been first deducted; provided that returns and other credits may be deducted only to the extent that the purchase to which the credit or return relates has been reflected in the previous balance. If the billing cycle is not monthly, such deduction shall be made for payments on account, returns and other credits made or given during that part of the billing cycle that

bears the same relation to the billing cycle that 25 does to 30.

3. If the billing cycle is monthly, the charge may not exceed 1½% of the amount pursuant to subsection 2. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. A billing cycle is monthly if the closing date of the cycle is the same date each month or does not vary by more than 4 days from the regular date.

4. Notwithstanding subsection 3, if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

5. No finance charge shall be imposed on purchases during the billing cycle, provided that they are paid for not later than 25 days after the closing date of the billing cycle in which the purchase or lease occurred.

6. For the purposes of this section, the term of a sale made pursuant to an open-end agreement commences with the date credit is granted or, if goods are delivered or services performed 10 days or more after that date, with the date of commencement of performance or with the date of completion of delivery. Delivery and performance include delivery or performance by a subcontractor or agent of the seller. [Comp. at § 4171.]

[Sec. 2-202, as amended by Laws 1977, law without approval June 30, 1977, Laws 1981, Ch. 323.]

## MARYLAND

## [§ 6336]

Sec. 12-506. Maximum finance charge—Open end account. (a) *Maximum finance charge.*

In an open end account, the finance charge may not be more than:

(1) 1.5 percent a month on that part of the outstanding balance not exceeding \$700;

(2) 1 percent per month on that part of the outstanding balance exceeding \$700.

(3) Notwithstanding the provisions of paragraph (a)(1) and (2), the finance charge may not exceed 2 percent per month on that part of the outstanding balance originating on or after July 1, 1982.

(4) In an open-end account, including a credit card plan that provides for sales, cash advances, or both, the buyer or borrower may not be required to pay a membership fee for the privilege of participating in the plan.

(5) With respect to an open-end account made at a rate pursuant to paragraph (3), the seller or holder may not contract for, charge or receive any compounded interest or compounded finance charge.

(6) A seller or financial institution may assess either, but not both:

(i) a finance charge equal to the rate of interest charged on past due accounts as provided in the agreement; or

(ii) A late payment charge.

(b) *Computation by balance ranges.*

In an open end account, if a finance charge is applied to all outstanding balances within a range not exceeding \$10, the finance charge may be computed on the basis of the median amount within the range.

(c) *Computation of outstanding balance.*

For the purpose of computing the outstanding balance of an open end account subject to the finance charge, the outstanding balance:

(1) On any day may not exceed the sum of the total charges to the account less the amounts paid or credited to the account before that day; or

(2) May be computed by the average daily balance method except that a finance charge may not be assessed on an account if the outstanding balance is paid in full 25 days after the billing cycle.

(d) *Limitation of finance charge.*

In an open end account, (1) the finance charge in any given month may not exceed an amount which may be assessed pursuant to subsection (c)(2) of this section; and (2) if there is no balance at the beginning of a billing cycle, a finance charge may not be assessed on any charge added to the account during that billing cycle from the date of purchase to the end of that billing cycle.

## [§ 6333]

Sec. 12-903. Interest and finance charges.

(a) *Authorized; balloon payments prohibited.*

(1) A credit grantor may charge and collect interest or finance charges under the plan on the outstanding unpaid indebtedness in the borrower's account under the plan at any daily, weekly, monthly, annual, or other periodic percentage rate as the agreement governing the plan provides, if the effective rate of simple interest does not exceed 24 percent per year. The rate of interest chargeable on a plan must be expressed in the agreement as a simple interest rate or rates.

(2) The repayment terms for a plan extended to a consumer borrower may not include a provision under which the consumer borrower may be required to pay a balloon payment at maturity. However, the adjustment of payment amounts, due to fluctuations in unpaid balance or rate of interest, may not be deemed to result in a balloon payment.

(b) *Calculation of interest.* With respect to a revolving credit plan of a consumer borrower, interest may be calculated on an amount not in excess of the average of the outstanding unpaid indebtedness for the applicable billing period, determined by dividing the total of the amounts of outstanding unpaid indebtedness for each day in the applicable billing period by the number of days in the billing period, or on an amount calculated by another balance computation method specified in the agreement.

(c) *Determination of billing period.* If the applicable periodic percentage rate under the agreement governing the plan is monthly, a billing period shall be deemed to be monthly if the last day of each billing period is on the same day of each month or does not vary by more than 4 days.

(d) *Limitations on imposition.* (1) Notwithstanding subsections (a) and (b) of this section:

(i) If the outstanding balance of purchase obligations under an open-end credit plan is paid in full within 25 days after the end of a billing period, a finance charge or interest may not be imposed on a consumer borrower with respect to such balance for that billing period; and

(ii) If there is no purchase balance at the beginning of a billing period, a finance charge or interest may not be imposed on a consumer borrower with respect to any purchase obligation added to the account during that billing period from the date of purchase to the end of that billing period;

(2) Notwithstanding paragraphs (i) and (ii) of this subsection, if the agreement governing a plan so provides, a finance charge or interest may be imposed from the date of purchase, if the agreement does not provide any charge permitted by § 12-903(a) [§ 6333] of this subtitle. [Comp. at § 4171, 4172.]

## MASSACHUSETTS

## [§ 6109]

Sec. 27. (contd.) [Finance charges for revolving credit agreement.] B. (1) An installment seller or holder thereof under a revolving credit agreement may assess a finance charge upon the installment buyer which shall not exceed one and one-half per cent per month computed upon the outstanding unpaid balance thereunder, from month to month, which need not be calendar month, or other regular period. The outstanding unpaid balance shall be determined consistent with clause (3). If the amount of any finance charge is less than fifty cents for any month, fifty cents may be assessed, provided that no finance charge is assessed for a zero balance. No installment seller or holder thereof under a revolving credit agreement shall impose a delinquency charge, late charge or similar charge.

(2) Finance charges may be computed under revolving credit agreements within a range of not in excess of ten dollars on the basis of the median amount within the selected range, provided that such finance charge is applied to all unpaid balances within such range.

3. (a) In the event that a finance charge is imposed, it shall be computed upon (i) the previous balance after all payments on account, returns and other credits made or given during the billing cycle shall have

been first deducted; provided, however, that returns and other credits may be deducted only to the extent that the purchase to which the credit or return relates has been reflected in the previous balance; or (ii) the average daily balance determined by adding the daily balances on the account for each day in the billing cycle, excluding purchases, and dividing this total by the number of days in the billing cycle. [Comp. at § 4171.]

[Sec. 27(B), as amended by Acts 1967, Ch. 775; Acts 1970, Ch. 822; Acts 1971, Ch. 86; Acts 1972, Ch. 783; Acts 1973, Ch. 273; Acts 1977, Ch. 52; Acts 1981, Ch. 384; Acts 1981, Ch. 733, approved and effective December 24, 1981.]

## MICHIGAN

## [§ 6134]

Sec. 448.962. (contd.) [Time price differential for retail charge agreement.] (c) A retail charge agreement may provide for, and the seller or holder may then, notwithstanding the provisions of any other law, charge, collect and receive, a time price differential for the privilege of paying in installments under the agreement, in an amount not exceeding 1.7% of the unpaid balance per month. The time price differential under this subsection shall be computed on all amounts unpaid under the agreement from month to month, which need not be calendar months, or other regular periods; but if the regular period is other than a monthly period or if the unpaid amount is less than or greater than \$10.00, the time price differential may be computed proportionately. The time price differential may be computed for all unpaid balances within a range of not in excess of \$10.00 on the basis of the median amount within that range if as so computed such time price differential is applied to all unpaid balances within such range. A minimum time price differential not in excess of 70 cents per month may be charged, received and collected. [Comp. at § 4171.]

.05. Average daily balance method.—Previous balance method.—A retailer's use of the average daily balance method on revolving charge accounts that included current purchases in its calculations did not violate the state retail installment sales law. The use of the previous balance method prior to the effective date of the sales act jibed with state usury law since the finance charges were characterized as a time-price differential rather than as interest.—*Gring v. Robinson Furniture Co.* (Mich. Ct. App., 1977) CCH CONSUMER CREDIT GUIDE, § 98,051, 260 N. W. 2d 898, reversing (Mich. Cir. Ct. 1974) CCH CONSUMER CREDIT GUIDE § 98,848.

## MINNESOTA

## [OPEN END CREDIT]

[§ 6101]

Sec. 334.16. Finance charges for open end credit sales. Subdivision 1. Limitation rates. The imposition, charge or collection of a finance charge upon an account balance by a seller of goods, services or other shall be lawful, provided that:

(a) The sale is a consumer credit sale pursuant to an open end credit plan, agreement or arrangement between the buyer and seller under which (1) the seller may permit the buyer to make purchases from time to time from the seller or other sellers, (2) the buyer has the privilege of paying the balance in full or in installments, and (3) a finance charge may be computed

by the seller from time to time on an outstanding unpaid balance; and

(b) The terms of the plan, agreement or arrangement provide for a periodic rate of finance charge which does not exceed 1½ percent per month computed on an amount no greater than the average daily balance of the account during each monthly billing cycle; provided a minimum finance charge not in excess of 50 cents per month may be imposed, charged or collected.

(c) No finance charge in excess of 1½ percent per month shall be imposed on an open-end and consumer credit account by any issuer whose credit card is issued primarily for the purpose of purchasing motor fuels and related products and whose gross

annual national sales exceed \$10 billion. Retailers must give adequate notice to open end consumer credit customers before any higher interest rate is applied. Accompanying credit statements must not suggest that the Minnesota legislature required retailers to raise interest rates. The accompanying material must make clear that the increase affects only the maximum allowable interest rate. [Comp. at § 4171.]

[Sec. 334.16(1), as amended by Laws 1980, Ch. 346; Laws 1985, Ch. 57, approved May 1, 1985, effective May 2, 1985.]

.01 1985 Amendment.—The amendment substituted the present language of subsection (c) beginning "any issuer" for "any seller whose Minnesota annual gross sales exceeds 25 million dollars." The amendment does not apply to account balances outstanding on May 2, 1985.—CCH.

[§ 6102]

Sec. 334.16 (contd.) Subd. 2. Definitions and computations. The definitions and the provisions on computation of percentage rates in the Truth-in-Lending Act [§ 3005—3045], Title I of the Consumer Credit Protection Act, P. L. 90-321, and in Regulation Z [§ 3501—3756] of the Board of Governors of the Federal Reserve System adopted pursuant thereto, 12 CFR 226, as in effect on June 5, 1971, shall apply to the terms used in sections 334.16 to 334.18, and computations thereunder.

Subd. 3. The calculation of the average daily balance for the purpose of the limitation on rates imposed by Subdivision 1, clause (b) shall be made by excluding from the daily balances the amount of each sale from the date of sale until the last day of the regular billing cycle during which the sale was made. The portion of any balance

arising from the sale of goods which are returned shall be excluded from the unpaid balance as of the date the goods are returned. [Comp. at § 4171.]



## MISSISSIPPI

## [T 6401A]

## Sec. 75-17-1 (contd.). (Revolving credit.)

(5) Notwithstanding the foregoing and any other provision of law to the contrary, any retail seller, and any lender or issuer of credit cards may lawfully contract for and receive a finance charge for credit sales of goods, services or merchandise certificates or for cash advanced or other credit extended pursuant to a revolving charge agreement by applying a periodic rate no greater than one and three-fourths percent (1 3/4%) per month through June 30, 1986, and thereafter no greater than one and one-half percent (1 1/2%) per month to:

(a) the average daily balance of the account, exclusive of finance charge, in each billing period;

(b) an amount that shall not exceed the balance of the account, exclusive of finance charge, on the first day of each billing period without adding purchases or miscellaneous debits to the account during the billing period; or

(c) any balance of the account during each billing period which does not produce an amount of finance charge in excess of that permitted by (a) or (b).

Notwithstanding the foregoing, from and after July 1, 1986, the maximum finance charge which may be charged or collected on any unpaid balance subject to finance charge which is in excess of Eight Hundred Dollars (\$800.00) shall be determined by applying a periodic rate no greater than one and one-quarter percent (1 1/4%) per month to that portion of the unpaid balance subject to finance charge which is in excess of Eight Hundred Dollars (\$800.00) but not greater than Twelve Hundred Dollars (\$1200.00), and by applying a periodic rate no greater than one percent (1%) per month to that portion of the unpaid balance subject to finance charge which exceeds Twelve Hundred Dollars (\$1200.00).

No finance charge may be charged or collected for purchases of goods or services or merchandise certificates until one (1) month after the billing statement date on the billing statement where such purchases initially appear, but any portion of the balance of such purchases which remains unpaid one (1) month after such billing statement date shall thereafter be subject to a

finance charge as provided herein, computed from and after the date of the billing statement upon which such purchases initially appear. If a finance charge is otherwise due and the amount of the finance charge so computed shall be less than Fifty Cents (50¢) for any such month, a finance charge of Fifty Cents (50¢) for any such month may be charged, received and collected. Any payment made pursuant to a revolving charge agreement shall be applied first to any finance charge shown to be due on the billing statement, next to repayment of cash advanced or other credit extended, and finally to the chronological repayment of purchases of goods, services or merchandise certificates. The billing statement shall not state that Mississippi law requires the imposition of a finance charge. The term "month" as used in this subsection (3) means either (i) a calendar month or (ii) a minimum of thirty (30) consecutive calendar days, or (iii) the number of days elapsing between the same numerical calendar day of successive calendar months, or a number of days which does not vary by more than four (4) days from such period nor result in more than twelve (12) billing periods per year. "Revolving charge agreement" means an agreement by the terms of which retail sellers may sell goods, services, merchandise certificates, or by which a lender or issuer finances the purchase of goods or services or by which a lender makes cash advances, by the use of credit cards or otherwise, pursuant to which the amount financed is payable either within a stated period or in installments over a period of time, and the terms of which may provide for finance charges to be assessed on the unpaid balance as it exists from time to time; the term "revolving charge agreement" does not include the lending of money evidenced by a promissory note.

(6) Notwithstanding the foregoing and any other provision of law to the contrary, any retail seller may contract for and receive a finance charge for closed end credit sales of goods, tangible property or services, other than pursuant to a revolving charge agreement, which will result in a yield not to exceed the following annual percentage rates calculated according to the actuarial method:

(a) Twenty-four percent (24%) per annum on that part of the unpaid balance of the amount financed which is Two Thousand Five Hundred Dollars (\$2,500.00) or less; and

(b) Twenty-one percent (21%) per annum on that part of the unpaid balance of

## MISSOURI

## [§ 6021]

Sec. 408.300. (cont'd) 2. [Time charges—Retail charge agreements.] Notwithstanding the provisions of any other law the seller and assignee under a retail charge agreement may charge, receive and collect a time charge which shall not exceed sixteen and seven-tenths cents per ten dollars per month on the unpaid balance. The time charge under this subsection shall be computed on an amount not exceeding the greater of either:

- (1) the average daily balance of the account in the billing cycle for which the charge is made, which is the sum of the amount unpaid each day during that cycle divided by the number of days in that cycle; amount unpaid on a day is determined by adding to any balance unpaid as of the beginning of that day all purchases and other debits and deducting all payments and other credits made or received as of that day; or

- (2) the unpaid balance of the account on the last day of the billing cycle after first deducting all payments, credits and refunds during the billing cycle; or for all unpaid balances within a range of not in excess of ten dollars on the basis of the median amount within such range, if as so computed such time charge is applied to all unpaid balances within such range. A minimum time charge not in excess of seventy cents per month may be charged, received and collected.

[Sec. 408.300(2), as amended by Laws 1975, S. B. 71; Laws 1979, S. B. 305; Laws 1980, H. B. 1195; Laws 1981, S. B. 5 and H. B. 256; Laws 1985, H. B. 358 and H. B. 440, approved June 18, 1985, effective September 28, 1985.]

.01 1985 Amendment.—The amendment changed the permitted time charge from 15¢ per \$10 per month on the unpaid balance to 16.7¢ per \$10 per month.—CCH.

## MONTANA

## [§ 5043]

Sec. 31-1-241. Finance charge limitation. (1) Notwithstanding the provision of any other law, the finance charge included in a retail installment contract shall be at a rate agreed upon by the retail seller and the buyer.

(2) Notwithstanding the provisions of any other law the finance charge in a retail charge account agreement shall be at a rate agreed upon by the retailer seller and the buyer. The finance charge shall be computed from month to month (which need not be a calendar month) or other regular billing cycle period by using the ending balance of the account as of the last day of the billing cycle less the amount of purchases charged to the account during that billing cycle.

(3) A seller may change the terms of a revolving charge account whether or not the change is authorized by prior agreement. The seller shall give the buyer written notice of any change in the two billing cycles prior to the effective date of the change.

(4) If the retail seller increases his finance charge on a retail charge account agreement, then such increased rate may only be applied to the balance consisting of purchases on other charges incurred on or after the effective date of the increase.

- (5) For purposes of determining the balance to which the increased rate applies, all payments may be considered to be applied to the balance existing prior to the change in rate until that balance is paid in full.

(6) If the finance charge determined pursuant to subsection (2) for a monthly period is less than 50 cents, a maximum finance charge not in excess of 50 cents may be charged and collected for such period. [Comp. at § 4151, 4171, 4710.]

[Sec. 31-1-241, as amended by Laws 1979, CA. 160; Laws 1981, CA. 276; Laws 1983, H. B. 63, approved and effective February 14, 1983.]

## NEBRASKA

[§ 6054]

Sec. 45-207. Time price differential—Rate  
 —Maximum. Notwithstanding the provisions of any other law the seller or assignee under a revolving charge agreement may charge, receive, and collect a time price differential which shall not exceed the following rate: One and three-quarters per cent per month on amounts less than five hundred dollars, and one and one half per cent per month on amounts of five hundred dollars or more. The rate shall be computed on the unpaid balance under the agreement from month to month, which need not be a calendar month, or other period as agreed, except that no time price differential shall be assessed on an account if payment of the outstanding balance is received prior to the beginning of the next billing cycle under the agreement. [Comp. at § 4171.]

[Sec. 45-207, as amended by Laws 1980, L. B. 308; Laws 1984, L. B. 736, approved March 27, 1984, effective July 10, 1984.]

## NEVADA

No Provision Located

## NEW HAMPSHIRE

No Provision Located

## NEW JERSEY

## [§ 6055B]

Sec. 17:16C-44.1. [Retail charge account time price differential.] (a) Notwithstanding any other law to the contrary, a retail seller, sales finance company, banking institution or other holder may charge, receive and collect a time price differential in each billing period on obligations incurred pursuant to any retail charge account, which shall be determined as specified in the terms of the account, subject to the limitations provided herein. Such time price differential for each monthly billing period shall not exceed the amount resulting from applying the periodic rates provided herein to the greater of the following amounts (including unpaid time price differentials):

- (i) The average daily balance of the account for such billing period, or
- (ii) The balance of the account at the beginning or end of such billing period.

The periodic rates shall not exceed an amount agreed to by the retail seller, sales finance company, banking institution, or other holder and the retail buyer.

The terms of the retail charge account may provide that the time price differential may be increased or may be decreased or both from time to time provided, however, that no increase shall be effective unless: (1) at least 90 days prior to the effective date of the first such increase, or 30 days prior to the effective date of any subsequent increase, a written notice has been mailed or delivered to the retail buyer that clearly and conspicuously describes such change and the indebtedness to which it applies and states that the incurrence by the retail buyer or another person authorized by him of any further indebtedness under the plan to which the agreement relates on or after the effective date of the increase specified in the notice shall constitute acceptance of the increase and (b) either the retail buyer agrees in writing to the increase or the retail buyer or another person authorized by him incurs such further indebtedness on or after the effective date of the increase stated in the notice. The provisions of this paragraph permitting an increase in the time price differential shall not apply in the case of an agreement which expressly prohibits changing of the time price differential or which provides limitations on changing of the time price differential which are more restrictive than the requirements of this paragraph. If the terms of the retail charge account provide for the possibility of an increase or decrease, or both, in the time price differential, that fact shall be clearly described in plain language, in at least 8-point bold face type of the face of the written notice.

Notwithstanding the foregoing limitation, if the terms of the account so provide, the time price differential may be computed on the median amount within a specified range. Such time price differential for each monthly billing period shall not exceed the amount

resulting from applying the respective periodic rates specified above to the median amount within the specified range in which the greater of the amounts specified in (i) and (ii) is included; provided, subject to the classifications and differentiations as may reasonably be established by the retail seller, sales finance company, banking institution or other holder, the same time price differential is charged on all balances within the specified range and provided further that the time price differential determined by applying the respective periodic rates specified above to the median amount within the range does not exceed by more than 8% the amount of the time price differential determined by applying the respective periodic rates specified above to the lowest amount in the range.

(b) If the billing period is not monthly, the maximum periodic rate shall be that rate which bears the same relation to the respective periodic rates per month specified above as the number of days in the billing period bears to 30.

(c) Notwithstanding the limitation provided in (a) above, for any monthly billing period in which a time price differential may be charged pursuant to the terms of the account a minimum time price differential of not more than \$0.50 may be charged; if the billing period is not monthly, a minimum time price differential may be charged in such amount which bears the same relation to \$0.50 as the number of days in the billing period bears to 30. [Comp. at § 4171.]

[Sec. 17:16C-44.1, as amended by Laws 1981, approved and effective March 31, 1981.]

## NEW MEXICO

## [§ 4017]

Sec. 56-1-3. (contd.) [Time price differential.] C. Notwithstanding the provisions of any other law, a retail charge agreement may provide for, and the seller or holder may then charge, collect and receive, a time price differential for the privilege of paying in installments thereunder.

The time price differential under this subsection shall be computed from month to month (which need not be a calendar month) or other regular period, on all amounts unpaid under the agreement at the beginning of each such period. The time price differential under this subsection may be computed for all unpaid balances within a range of not in excess of ten dollars on the basis of the median amount within such range, if as so computed such time price differential is applied to all unpaid balances within such range.

A retail charge agreement may also provide for the payment of an attorney's reasonable fee where it is referred for collection to an attorney not a salaried employee of the holder of the retail charge agreement or any unpaid balance thereunder, and for court costs and disbursements. [Comp. at § 4171.]

[Sec. 56-1-3 C, as amended by Laws 1980, Ch. 72; as amended by Laws 1981, Ch. 196.]

## NEW YORK

[§ 6000]

Revised Effective until 6-30-67

## Sec. 413. (amended.) [Credit service charge for agreement—Computation—Limitation.]

3(a). A seller may, in a retail installment credit agreement, contract for and, if so contracted for, the seller or holder thereof may charge, receive and collect the service charge authorized by this article. The service charge shall not exceed the rate or rates agreed upon by the seller and the buyer including, in accordance with the provisions of the credit agreement, rates that may vary, from time to time computed, for the purposes of this section, on the outstanding indebtedness from month to month, or if the service charge so computed is less than seventy cents for any month, seventy cents. If the credit agreement provides for a variable rate of service charge, the rate shall be determined at regular intervals as set forth in the credit agreement and in accordance with such regulations as the banking board shall prescribe but said rate shall not vary more often than once in any three month period and shall be based on a published index that is (a) readily available, (b) independently verifiable, (c) beyond the control of the seller and (d) approved by the superintendent.

The banking board shall adopt regulations with respect to credit agreements that provide for a variable rate of service charge, including but not limited to: (a) providing for disclosure to the buyer by the seller of the circumstances under which the rate may increase, any limitations on the increase, the effect of an increase and an example of the payment terms that would result from an increase; (b) providing for disclosure to the buyer by the seller of a history of the fluctuations of the index over a reasonable period of time; and (c) providing for notice to the buyer by the seller prior to any rate increase or change in the terms of payment; (d) such charges in credit agreements shall be based on the index values, or the index numbers plus or minus additional percentage points provided, however, that variations in the charge must correspond directly to the movements of the index values plus or minus additional percentage points only. Once such charge is established no lending institution may add any factors to increase the charge

other than variations in the established index without the prior approval of the banking board.

(b) If the credit agreement so provides, the service charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amount minus a differential of not more than five dollars, provided that it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential.

(c)(i) For the purposes of this subdivision the term "outstanding indebtedness from month to month" shall mean, at the election of the seller, holder or financing agency either:

(a) the amount unpaid at the beginning of the monthly period, including unpaid service charges, less all payments received and credits issued during the billing period, except for credits attributable to amounts not included in the previous balance; or

(b) an amount not to exceed the amount calculated by adding the amounts unpaid for each day of the monthly billing period, including unpaid service charges, after reflecting that day's purchases made, payments received, credits issued and other adjustments, and dividing such sum by the number of days in the billing period.

(ii) Notwithstanding the above, no seller may impose a service charge for any monthly billing period in which there is no previous balance or during which the sum of the payments received and other credits issued which are attributable to amounts included in the previous balance is equal to or exceeds the amount of such previous balance.

(iii) The term "billing period" as used in this subdivision shall mean the time interval between periodic statement dates, pursuant to subdivision four of this section. A billing period shall be considered to be a "month" or "monthly" if the last day of each billing period is on the same day of each month or does not vary by more than four days therefrom.

(d) Where a retail installment credit agreement provides that the buyer has the option of avoiding the imposition of an additional service charge by paying the outstanding indebtedness or any portion thereof within a specified period of time, the additional service charge may not be imposed unless the monthly statement showing such outstanding indebtedness or portion thereof is mailed at least fifteen

days prior to the date by which payment must be received to avoid that service charge. A seller or holder shall not be prohibited from imposing a service charge, or required to refund a service charge, if failure to comply with the provisions of this paragraph resulted from circumstances beyond the control of the seller or holder, notwithstanding reasonable procedures to insure compliance with this paragraph.



## -NEW YORK (contd.)

—Effective 6-30-67 —

Sec. 413. (contd.) [Credit service charge for agreement—Computation—Limitation.] 3. A seller may, in a retail instalment credit agreement, contract for and, if so contracted for, the seller or holder thereof may charge, receive and collect the service charge authorized by this article. The service charge shall not exceed the following rates computed, for the purposes of this section, on the outstanding indebtedness from month to month:

(a) On so much of the outstanding indebtedness as does not exceed five hundred dollars, one and one-half per centum per month;

(b) If the outstanding indebtedness is more than five hundred dollars, one per centum per month on the excess over five hundred dollars of the outstanding indebtedness; or

(c) If the service charge so computed is less than seventy cents for any month, seventy cents.

(d) If the credit agreement so provides, the service charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amount minus a differential of not more than five dollars, provided that it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential.

(e)(i) For the purposes of this subdivision the term "outstanding indebtedness from month to month" shall mean, at the election of the seller, holder or financing agency either:

(a) the amount unpaid at the beginning of the monthly period, including unpaid services charges, less all payments received and credits issued during the billing period, except for credits attributable to amounts not included in the previous balance; or

(b) an amount not to exceed the amount calculated by adding the amounts unpaid for each day of the monthly billing period, including unpaid service charges, after reflecting that day's purchases made, payments received, credits issued and other adjustments, and dividing such sum by the number of days in the billing period.

(ii) Notwithstanding the above, no seller may impose a service charge for any monthly billing period in which there is no previous balance or during which the sum of the payments received and other credits issued which are attributable to amounts included in the previous balance is equal to or exceeds the amount of such previous balance.

(iii) The term "billing period" as used in this subdivision shall mean the time interval between periodic statement dates, pursuant to subdivision four of this section. A billing period shall be considered to be a "month" or "monthly" if the last day of each billing period is on the same day of each month or does not vary by more than four days therefrom.

(f) Where a retail instalment credit agreement provides that the buyer has the option of avoiding the imposition of an additional service charge by paying the outstanding indebtedness or any portion

thereof within a specified period of time, the additional service charge may not be imposed unless the monthly statement showing such outstanding indebtedness or portion thereof is mailed at least fifteen days prior to the date by which payment must be received to avoid that service charge. A seller or holder shall not be prohibited from imposing a service charge, or required to refund a service charge, if failure to comply with the provisions of this paragraph resulted from circumstances beyond the control of the seller or holder, notwithstanding reasonable procedures to insure compliance with this paragraph.

## NORTH CAROLINA

[§ 6419]

**Sec. 24-11. Certain revolving credit charges.** (a) On the extension of credit under an open-end credit or similar plan (including revolving credit card plans, and revolving charge accounts, but excluding any loan made directly by a lender under a check loan, check credit or other such plan) under which no service charge shall be imposed upon the consumer or debtor if the account is paid in full within twenty-five (25) days from the billing date, but upon which there may be imposed an annual charge not to exceed twenty dollars (\$20.00), there may be charged and collected interest, finance charges or other fees at a rate in the aggregate not to exceed one and one-half per cent (1½%) per month computed on the unpaid portion of the balance of the previous month less payments or credit within the billing cycle or the average daily balance outstanding during the current billing period. No person, firm or corporation may charge a discount or fee in excess of six percent (6%) of the principal amount of the accounts acquired from or through any ven-

dor or others providing services who participate in such plan.

(b) On revolving credit loans (including check loans, check credit or other revolving credit plans whereby a bank, banking institution or other lending agency makes direct loans to a borrower), if agreed to in writing by the borrower, such lender may collect interest and service charges by application of a monthly periodic rate computed on the average daily balance outstanding during the billing period, such rate not to exceed one and one half percent (1½%).

(c) Any extension of credit under an open-end or similar plan under which there is charged a monthly periodic rate greater than one and one-quarter percent (1¼%) may not be secured by real or personal property or any other thing of value, provided, that this subsection does not apply to consumer credit sales regulated by Chapter 25A, the Retail Installment Sales Act; provided further, that in any action initiated for the possession of property in which a security interest has been taken, a judgment for the possession thereof shall be restricted to commercial units (as defined in G. S. 25-2-105(6)) for which the cash price was one hundred dollars (\$100) or more.

(d) The term "billing date" shall mean any date selected by the creditor and the bill for the balance of the account must be mailed to the customer as least 14 days prior to the date specified in the statement as being the date by which payment of the new balance must be made in order to avoid the imposition of any finance charge.

## NORTH DAKOTA

[§ 51-14-03]

**Sec. 51-14-03. Limitation of credit service charge.** A seller may, in a revolving charge agreement, contract for and, if so contracted for, the seller or holder thereof may charge, receive and collect the service charge authorized by this section. The service charge shall not exceed one and one-half per cent per month computed on the outstanding indebtedness from month to month. In the event any payment by a buyer is insufficient to pay both the credit service charge and that portion of the outstanding indebtedness then due, such payments shall first be applied to the credit service charge then due. [Comp. at § 4171.]

## OHIO

(A) Such agreements, in this section called revolving budget agreements, and sales made pursuant thereto, shall be governed solely by and shall comply with this section. A copy of any such agreement executed after January 1, 1960, shall be delivered to the retail buyer by the retail seller, or his successor in interest, in this section called "holder," within thirty days after its execution, but in no event later than the date on which the first payment is due thereunder. The copy shall state the maximum amount or rate of the finance charge permitted to be charged, collected, and received under a revolving budget agreement pursuant to the provisions of division (B) of this section.

The retail seller or holder under any revolving budget agreement shall supply the retail buyer thereunder with a statement as of the beginning or end of each period in which there is any unpaid balance thereunder, which may be a calendar month or other regular period not in excess of thirty-one days, agreed upon by the seller or holder and buyer. The statement shall recite the following:

(1) The unpaid balance under such agreement at the beginning and end of the period;

(2) Unless otherwise furnished by the retail seller or holder to the retail buyer by sales slip, memorandum, or otherwise, an identification of the goods purchased during the period, the cash purchase price, and the date of each purchase;

(3) The payments made by the retail buyer to the retail seller or holder and any other credits to the retail buyer during the period;

(4) The amount of the finance charge, if any;

(5) A legend to the effect that the retail buyer may at any time pay his unpaid balance without incurring further charges.

(B) The following provisions shall control the amount of the finance charge that may be contracted for, charged, collected, and received with respect to any sale made

pursuant to a revolving budget agreement, notwithstanding the provisions of section 1317.06 [§ 6006] of the Revised Code. Finance charges and service charges not in excess of the amount excepted by section 1317.06 [§ 6006] of the Revised Code from the application of sections 1317.01 to 1317.11 of the Revised Code, may continue to be contracted for, charged, collected, and received with respect to any other sale without regard to whether said sections are otherwise applicable thereto. A retail seller or holder under a revolving budget agreement may charge, collect, and receive a finance charge that shall not exceed the sum obtained by applying to the unpaid balance, including therein any arrearages of finance charges, at the beginning or end of each period or upon the average daily balance during each period, a finance charge at a rate not exceeding one and one-half percent per month.

If the finance charge so computed is less than one dollar for any such monthly period, the retail seller or holder may nevertheless charge, collect, and receive not in excess of one dollar for such month's charges.

No change in terms of a revolving budget agreement shall be made to permit a retail seller to charge, collect, or receive a finance charge computed by applying the finance charge rate to the average daily balance during each period rather than to the unpaid balance at the beginning or end of each period as provided in such agreement unless at least thirty days prior to the effective date of such change a written notice has been mailed or delivered to the buyer which describes such change in terms and states that a purchase or other charge on the account made by the buyer or other person authorized by him on or after the effective date stated in the notice shall constitute acceptance of such change in terms.

No delinquent or pre-payment charges are permitted under a revolving budget agreement, but this shall not prevent a retail seller or holder from including in the unpaid balance finance charges theretofore incurred. [Comp. at § 4043, 4111, 4171.]

[Sec. 1317.11, as last amended by Laws 1961, H. B. No. 1; Laws 1980, H. B. 708 approved and effective March 31, 1980]

## OKLAHOMA

**[§ 5067] Credit Service Charge for Revolving Charge Accounts**

**Sec. 2.207.** (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

- (a) the average daily balance of the account,
- (b) the unpaid balance of the account on the same day of the billing cycle, or

(c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8 per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and  $1\frac{1}{4}$  per cent on that part of this amount which is more than \$500. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the same day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) The amounts of \$500 in subsection (3) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

**Oklahoma.** In subsection (3) substitute "one and three-fourths percent ( $1\frac{3}{4}\%$ )" for "2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and  $1\frac{1}{4}$  per cent on that part of this amount which is more than \$500". Omit subsection (5).

[Sec. 2.207, as modified by Laws 1981, Ch. 177, approved May 18, 1981, effective October 11, 1981.]

## OREGON

No Provision Located

## PENNSYLVANIA

## [§ 6270]

Sec. 904. (69 P. S. 904) [Service charge limitation—Installment accounts.] Subject to the other provisions of this article [§ 6267-6277] the seller or holder of a retail installment account may charge, receive and collect the service charge authorized by this act. The service charge shall not exceed the following rates computed on the outstanding balances from month to month:

(a) On the outstanding balance, one and one-half percent (1½%) per month.

(b) A minimum service charge of seventy cents (70¢) per month may be made for each month if the service charge so computed is less than that amount; such minimum service charge may be imposed for a minimum period of six months.

(b.1) Notwithstanding the rate provided for in clause (a), no issuer of a credit card primarily engaged as a seller or distributor of gasoline shall be permitted to charge, receive or collect a service charge in excess of fifteen percent (15%) simple interest per annum on unpaid balances.

(c) The service charge may be computed on a schedule of fixed amounts if as so computed it is applied to all amounts of outstanding balances equal to the fixed amount minus a differential of not more than five dollars (\$5), provided that it is also applied to all amounts of outstanding balances equal to the fixed amount plus at least the same differential. [Comp. at § 4171.]

[Sec. 904, as amended by Laws 1982, Act 68; Laws 1985, Act 2, approved and effective March 1, 1985.] (Note: Section 2 of Laws 1985, Act 2, provides that the rate provided in subsection (a) will revert March 1, 1988 to the rate in effect prior to March 25, 1982, which was 1¼% per month.—CCH.)

41 Previous balance method.—Use of the previous balance method to compute charges on revolving charge accounts is illegal. The court noted that although the statute did not specifically prohibit this method, analysis showed that it had the effect of doing so. The disclosures required on the billing statement showed that the Legislature contemplated a charge calculated on an unpaid balance determined after the deduction of payments and the addition of purchases. The previous balance method does not utilize such calculations, and so it is not an acceptable method under the law.—*Hoad v. Pittsburgh National Bank* (CA-3 1975) CCH CONSUMER CREDIT GUIDE ¶ 98,532, 526 F. 2d 1083, reversing (DC Pa. 1974) CCH CONSUMER CREDIT GUIDE ¶ 98,706, 381 F. Supp. 801.

## PUERTO RICO

## Sec. 2: Determination of Finance Charges.

A. The Secretary may issue orders revising interest rates and/or finance charges applicable to all commercial enterprise revolving charge account plans and commercial enterprise credit card transactions taking into consideration the following criteria as well as any limitation established in this Regulation:

1. Cost of funds and operations involved in financing said transactions;
2. Market conditions;
3. The interests of all the affected parties; and
4. Any other necessary economic factor for said order. [Comp. at §4171.]

## Sec. 3: Computation of Finance Charges.

A. The finance charges on sales of merchandise and/or services shall be computed using the Average Daily Balance system so that all payments and credits will be credited from the day in which they are received and before any finance charge is computed, and the credit purchases will be charged from the date of purchase.

B. The Average Daily Balance will be determined by adding the balances owed each day comprised within the billing period and dividing the resulting total by the number of days within said period. The outstanding balance during each day within the billing period will be determined by adding the final balance of the previous day, plus any other purchase or miscellaneous debit and subtracting from these any payments and miscellaneous credits made during the day.

C. There will be no finance charge for billing periods in which no previous balance exists or during which the payments and credits equal or exceed the previous balance. The finance charges shall be computed on principal only.

D. In computing finance charges, a system more liberal and less expensive to the consumer than the Average Daily Balance may be used.

E. No charge or additional expense other than those authorized in Part II of this Regulation shall be charged, reserved, collected, received or contracted.

## RHODE ISLAND

## [§ 6014]

Sec. 6-27-4 (contd.). [Revolving credit plan charges—Minimum—Free period.] (b) No creditor shall impose in any revolving or open-end credit plan a finance charge on any periodic balance in excess of twenty-one per cent (21%) per annum except that such a creditor may impose a minimum finance charge of not in excess of fifty cents (50¢) per month for any period during which there is a balance due the creditor; provided however, that except for cash advances no further finance charge shall be imposed on any balance due at the end of any billing period which is paid in full within twenty-one (21) days after furnishing to such persons a clear statement in writing setting forth to the extent applicable and ascertainable, (a) the unpaid balance of the account of such person as of the beginning of such period; (b) the amount of each extension of credit to such person (including the cash price or delivered price of any property or service acquired by such person) during such period and, unless previously furnished, the date thereof and a brief identification of any property or service so acquired; (c) the total amount received, or credit to the account of, such person during such period, whichever is the later. [Comp. at §4001, 4171.] [Sec. 6-27-4(b), as amended by Laws 1968, Ch. 184; Laws 1970, Ch. 223; Laws 1982, Ch. 436, approved and effective May 26, 1982.]



## SOUTH CAROLINA

## [§ 5077]

**Sec. 37-2-207. Credit service charge for revolving charge accounts.** (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section, but if they do not so contract in writing, no charge shall be made.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

(a) the average daily balance of the account;

(b) the unpaid balance of the account on the same day of the billing cycle, or

(c) the median amount within a specified range within which the average daily balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than eight per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed that authorized by Section 37-2-201 [§ 5071] on the amount specified in subsection (2) of this section. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to thirty. For the purposes of this section, a variation of not more than four days from month to month is the same day of the billing cycle.

(4) Notwithstanding subsection (3), if there is an unpaid balance on the same date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding fifty cents if the billing cycle is monthly or longer, or the pro rata part of fifty cents which bears the same relation to fifty cents as the number of days in the billing cycle bears to thirty if the billing cycle is shorter than monthly.

(5) Notwithstanding subsection (3) and except for subsection (4), no less than forty percent of any scheduled minimum payment for that billing cycle must be applied to principal reduction in that billing cycle. [Comp. at § 4171.]

[Sec. 37-2-207, as amended by Laws 1980, Act 433; Laws 1982, S. B. 798, approved May 31, 1982, effective June 30, 1982.]

## [§ 6063]

**Sec. 34-11-4.2. Amount of service charge—Requirements—Compounding charge.** A charge may be made in each billing cycle which is a percentage of an amount no greater than the average daily balance of the account, the unpaid balance of the account on approximately the same day of the billing cycle or the median amount within a specified range within which the average daily balance or the unpaid balance of the account, on approximately the same day of the billing cycle, is included. A charge may be made pursuant to this section only

if the same charge is applied to all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than eight percent of the charge on the median amount. This charge may be compounded. [Comp. at § 4171.]

## SOUTH DAKOTA

No Provision Located

## TENNESSEE

## [Y6013]

Sec. 47-11-104. (c) *Time price differential.* Notwithstanding the provisions of any other law the seller and assignee under a retail charge agreement may charge, receive and collect a time price differential which shall not exceed seventeen and one-half cents (17½¢) per ten dollars (\$10.00) per month, computed from month to month (which need not be a calendar month) or other regular period, on all amounts unpaid from time to time under the agreement. The time price differential under this subsection (c) may be computed for all unpaid balances within a range of not in excess of ten dollars (\$10.00) on the basis of the median amount within such range, if as so computed such time price differential is applied to all unpaid balances within such range. A minimum time price differential not in excess of seventy cents (70¢) per month may be charged, received and collected under each such agreement. [Comp. at 4171.]

[Sec. 47-11-104(c), as amended by Laws 1982, Ch. 723, approved April 16, 1982, effective July 1, 1982; reenacted by Laws 1983, Ch. 328, approved and effective May 17, 1983.]

## TEXAS

## [§ 6018]

Art. 6.03. (contd.) [Time price differential rates.] (3) A retail charge agreement may provide for, and the seller or holder may then, notwithstanding the provisions of any other law, charge, collect and receive a time price differential for the privilege of paying in installments thereunder, which shall not exceed the following:

(a) On so much of the unpaid balance as does not exceed Five Hundred Dollars, Fifteen Cents per Ten Dollars per month; and

(b) If the unpaid balance exceeds Five Hundred Dollars, Ten cents per Ten Dollars per month on that portion over Five Hundred Dollars. [Comp. at § 4171.]

## [§ 6019]

Art. 6.03. (contd.) [Computation of time price differential—Minimum charge—Attorney's fee.] (4) The time price differential under this Article shall be computed on all amounts unpaid thereunder from month to month (which need not be a calendar month) or other regular period; provided, however, if the regular period is other than a monthly period such time price differential shall be computed proportionately. The time price differential under this Article may be computed for all unpaid balances within a range of not in excess of Ten Dollars on the basis of the median amount within such range, if as so computed such time price differential is applied to all unpaid balances within such range. A minimum time price differential not in excess of Seventy-five Cents per month may be charged, received and collected for any billing cycle in which a balance is due. In addition, such retail charge agreement may provide for the payment of an attorney's reasonable fee where it is referred for collection to an attorney, not a salaried employee of the holder of the contract, and for court costs and disbursements. [Comp. at § 4171, 4250.]

## [§ 6019A]

Art. 6.03. (contd.) [Alternative rates.] (5) The dollar amount of the rate brackets in this Article is subject to adjustment from time to time under Article 2.08 of this Title. As an alternative to the rates or amounts of time price differential provided by Section (3) of this Article, the parties may agree to any rate or amount of time price differential not exceeding a rate or amount authorized by Article 1.04 of this Title.

## UTAH

## [§ 5063]

Sec. 70C-4-103. [Finance charge calculation.] With respect to an open-end consumer

credit contract, a finance charge may only be calculated during any particular billing cycle on the basis of either:

(1) the average or actual daily balance of the account; or

(2) the unpaid balance of the account on the last day of the billing cycle after deducting payments and credits received during the same cycle. [Comp. at § 4171, 4172.]

## VERMONT

## [§ 6024]

Sec. 2406 (contd.). (c) [Finance charge.] A retail charge agreement may provide for and the seller or holder may then, notwithstanding the provisions of any other law, charge, collect and receive, in addition to the cash price a charge for the privilege of making deferred payments thereunder, which charge shall not exceed the rates authorized by section 41a(b)(9) of this title. If the amount of the finance charge otherwise permitted hereunder shall be less than fifty cents for any month or longer regular period fifty cents may nevertheless be charged, received and collected. In addition a retail charge agreement may provide for the payment of an attorney's reasonable fee where it is referred for collection to an attorney not a salaried employee of the holder of the retail charge agreement or any indebtedness thereunder and of court costs and disbursements and also of actual and reasonable out-of-pocket expenses incurred in connection with the collection. [Comp. at ¶ 4171, 4250.]

[Sec. 2406(c), as amended by Laws 1980, Act 173; Laws 1984, Act 214, approved May 9, 1984, effective July 1, 1984.]

(9) For a retail charge agreement the finance charge shall be the rate or rates agreed upon by the parties to such charge agreement but not to exceed twenty-one percent per annum. However, no finance charge may be imposed for any monthly billing period in which there is no previous balance, or during which the sum of the payments received and other credits issued are equal to or exceed the amount of the previous balance. The term "billing period" shall mean the time interval between periodic statement dates. A billing period shall be considered a month or monthly if the last day of each billing period is on the same day of each month or does not vary by more than four days therefrom. For a retail charge agreement, the periodic billing can be no less than 1/48th of the balance as of the last advance.

## VIRGINIA

## [§ 6017]

Sec. 6.1-330.20. Open end sales and loan plans. A. Any seller or lender engaged in the extension of credit under an open-end credit or similar plan under which a service charge is imposed upon the cardholder or consumer if payment in full of the unpaid balance is not received at the place designated by the creditor prior to the next billing date (which shall be at least twenty-five days later than the prior billing date), may charge and collect a service charge at such rate or rates as may be agreed upon by the seller or lender and the cardholder or consumer, computed at the option of the seller or lender on either (1) the average daily balance for the period ending on the billing date or (2) the balance existing on the billing date of the month, or (3) any other balance which does not result in the seller or lender charging and receiving any sum in excess of what would be charged and received in (1) or (2) above. No service charge shall be charged unless the bill is mailed not later than eight days (excluding Saturdays, Sundays and holidays) after the billing date, except that such time limitation shall not apply in any case where the seller or lender has been prevented, delayed, or hindered in mailing or delivering the bill within such time period because of an act of God, war, civil disorder, natural disaster, strike, or other excusable or justifiable cause. Notwithstanding the provisions of this section, a seller or lender may charge and collect a minimum service charge of one-half dollar per month; however, no service charge shall be charged against a zero balance. For the purposes of this section the average daily balance for any pe-

riod shall be that amount which is the sum of the actual amounts outstanding each day during the period, divided by the number of days in the period.

## WASHINGTON

## [§ 6017]

Sec. 63.14.130. Retail installment contracts and retail charge agreements—Service charge, composition, other fees and charges prohibited—Maximums. The service charge shall be inclusive of all charges incident to investigating and making the retail installment contract or charge agreement and for the privilege of making the installment payments thereunder and no other fee, expense or charge whatsoever shall be taken, received, reserved or contracted from the buyer.

(1) The service charge, in a retail installment contract, shall not exceed the highest of the following:

(a) A rate on outstanding unpaid balances which exceeds six percentage points above the average, rounded to the nearest one-quarter of one percent, of the equivalent common issue yields (as published by the Federal Reserve Bank of San Francisco) of the bill rates for twenty-six week treasury bills for the last market auctions conducted during February, May, August and November of the year prior to the year in which the retail installment contract is executed; or

(b) Ten dollars.

(2) The service charge in a retail charge agreement, revolving charge agreement, lender credit card agreement, or charge agreement, shall not exceed one and one-half percent per month on the outstanding unpaid balances. If the service charge so computed is less than one dollar for any month, then one dollar may be charged.

(3) A service charge may be computed on the median amount within a range which does not exceed ten dollars and which is a part of a published schedule of consecutive ranges applied to an outstanding balance, provided the median amount is used in computing the service charge for all balances within such range. [Comp. at § 4151, 4171.]

[Sec. 63.14.130, as amended by Laws 1981, Ch. 77; Laws 1984, Ch. 280, approved March 29, 1984, effective June 7, 1984.]

## WEST VIRGINIA

(5) "Average daily balance" in a billing cycle for which a sales finance charge or loan finance charge is made is the sum of the amount unpaid each day during that cycle divided by the number of days in that cycle. The amount unpaid on a day is determined by adding to the balance, if any, unpaid as of the beginning of that day all purchases and other debits and deducting all payments and other credits made or received as of that day.

## [§ 5083]

Sec. 46A-3-103. Sales finance charge for revolving charge accounts other than certain sales of real estate. (1) With respect to a consumer credit sale made pursuant to a revolving charge account, other than sales of real estate pursuant to section one hundred two of this article [§ 5082], the parties may contract for the payment by the buyer of a sales finance charge not exceeding that permitted in this section.

(2) A sales finance charge may be made in each billing cycle which is a percentage of an amount not exceeding the greatest of:

(a) The average daily balance of the account, or

(b) The balance of the account at the beginning of the first day of the billing cycle, less all payments on and credits to such account during such billing cycle and excluding all charges to such account during such billing cycle, or

(c) The median amount within a specified range within which the average daily balance of the account or the balance of the account at the beginning of the first day of the billing cycle, less all payments on and

credits to such account during such billing cycle and excluding all charges to such account during such billing cycle, is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than eight percent of the charge on the median amount.

(3) If the billing cycle is monthly, the sales finance charge may not exceed one and one-half percent on the first seven hundred fifty dollars of unpaid balance and one percent on the unpaid balance in excess of seven hundred fifty dollars. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to thirty. A billing cycle is monthly if the billing statement dates are on the same day each month or do not vary by more than four days therefrom.

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the sales finance charge is applied, the seller may contract for and receive a charge not exceeding fifty cents if the billing cycle is monthly or longer, or the pro rata part of fifty cents which bears the same relation to fifty cents as the number of days in the billing cycle bears to thirty if the billing cycle is shorter than monthly.

## WISCONSIN

[T 5053]

Sec. 422.201 (contd.). [Finance charge—Open end credit transactions.] (10) With respect to consumer credit transactions pursuant to an open-end credit plan entered into before the effective date of this act (November 1, 1961), the parties may agree to the payment by the customer of a finance charge not in excess of those permitted by sub. (2) or (3), whichever is applicable.

(a) A finance charge shall be deemed not to exceed such rates, if it is determined by applying a periodic rate not in excess of those specified in par. (b) or (c) to:

1. The average daily balance of the account;

2. The unpaid balance of the account on the last day of the billing cycle calculated after first deducting all payments, credits and refunds during the billing cycle; or

3. The median amount within a specified range within which the unpaid balance as calculated according to subd. 1 or 2 is included. A charge may be made pursuant

to this paragraph only if the creditor, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not exceed the charge resulting from applying that percentage to the lowest amount within the range by more than 8% of the charge on the median amount.

(c) A finance charge determined by application of a periodic rate not in excess of those permitted in par. (d) or (e) shall be determined by applying the periodic rate permitted in par. (d) or (e) to one of the following:

1. The average daily balance of the account.

2. The unpaid balance of the account on the last day of the billing cycle after first deducting all payments, credits and refunds during the billing cycle.

3. The median amount within a specified range within which the unpaid balance as calculated according to subd. 1 or 2 is included. A charge may be made under this subdivision only if the creditor, subject to classifications and differentiations the creditor may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not exceed the charge resulting from applying that percentage to the lowest amount within the range by more than 8% of the charge on the median amount.



## WYOMING

## [§ 5067]

Credit Service Charge for Revolving  
Charge Accounts

Sec. 2.207. (1) With respect to a consumer credit sale made pursuant to a revolving charge account, the parties to the sale may contract for the payment by the buyer of a credit service charge not exceeding that permitted in this section.

(2) A charge may be made in each billing cycle which is a percentage of an amount no greater than

- (a) the average daily balance of the account,
- (b) the unpaid balance of the account on the same day of the billing cycle, or
- (c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations he may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8 per cent of the charge on the median amount.

(3) If the billing cycle is monthly, the charge may not exceed 2 per cent of that part of the amount pursuant to subsection (2) which is \$500 or less and 1½ per cent on that part of this amount which is more than \$500. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than 4 days from month to month is "the same day of the billing cycle."

(4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding 50¢ if the billing cycle is monthly or longer, or the pro rata part of 50¢ which bears the same relation to 50¢ as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.

(5) The amounts of \$500 in subsection (3) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

Wyoming. Omit subsection (5). Subsection (3) has been amended to read as follows: "(3) Except as provided in paragraph (b) of this subsection:

(a) if the billing cycle is monthly, the charge may not exceed one and three-fourths percent (1.75%) of the amount pursuant to subsection (2) of this section; or

(b) if the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to thirty (30). For the purposes of this section, a variation of not more than four (4) days from month to month is 'the same day of the billing cycle'."

[Sec. 40-14-218, as amended by Laws 1981, Ch. 147, approved March 5, 1981, effective May 20, 1981.]

Senator GORTON. Thank you, Mr. Feldman, and I really want to thank all witnesses, but particularly this panel. You really have been hustled in a sense because of this 11 o'clock markup and we appreciate your accommodating us and your testimony will be carefully considered.

I have only one question that I will submit orally but a number in written form.

Mr. Craft, you didn't take the opportunity to comment on Mr. Fox's statement that you misinterpreted the University of Virginia study, that in fact there's a good 2-to-1 difference between finance charges due to differences in the ways in which different banks use the balance calculation method, rather than a very small difference. I'll give you an opportunity to do so briefly now if you would like.

Mr. CRAFT. Included in our testimony were the methods used to determine the average daily balance. What we did not have that Mr. Fox referred to was the impact of the grace period and the retroactive that does impact within a 1-month billing for the consumers. On an ongoing basis, that average daily balance is much more in line with the average daily balance used in our testimony.

I believe that's the difference that Mr. Fox referred to.

Senator GORTON. I would appreciate your looking at his testimony and at that study again and amplifying these remarks and the changes for us in writing.

[Response to Senator Gorton's question from Mr. Craft may be found on p. 140.]

Mr. CRAFT. We would be delighted to respond to the committee in writing.

Senator GORTON. Senator D'Amato.

#### REFINEMENT NEEDED IN THE BILLS

Senator D'AMATO. Mr. Chairman, just an observation that obviously Ms. Fernstrom made a very relevant point, and Mr. Feldman also in regard to the retailers, particularly those who may not have some of the capabilities that would make it rather difficult to comply with the average daily balance. I think we've got to look into that and see if we can't deal with that problem maybe in terms of what the gross volume is, et cetera, and I think we look forward and our staffs would look forward to working with you toward attempting to accommodate that situation. We are not looking to put the small retailer in a difficult economic position.

By the same token, I think Senator Gorton's legislation concerns a critical area of disclosure. I think we can come up with something. So we look forward to working with you.

Senator GORTON. Thank you all very much for being with us today.

This hearing is adjourned.

[Whereupon, at 11 a.m., the hearing was adjourned.]

[Response to written questions of Senator Gorton and D'Amato with additional material supplied for the record follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GORTON FROM  
ALAN FOX

Q.1. I have stated that I am willing to sacrifice some comprehensiveness of disclosure in order to get simplicity, because I believe that a simple disclosure of the most important points will better serve consumers than an exhaustive disclosure, especially at the solicitation stage. Do you agree with this general principle? Is it sufficient to disclose simply the APR, annual fee, and existence of a free period?

A. 1. Yes. As I indicated in my oral statement, there are four key elements to credit card pricing. These are the factors which should be addressed by the legislation. One of the factors, balance calculation method, should be dealt with through standardization. The other three factors, normally the APR, annual fee and free period, should be fully disclosed at the solicitation stage.

The legislation should be flexible enough to include common alternatives to these three factors, such as per transaction charges, which may be routinely applied under some accounts. In general, conditions that will be applied for routine and proper use of the card should be disclosed in the solicitation. Other fees which are not assessed for routine and proper use, such as late fees or fees for exceeding a credit limit, need not be included in legislation directed at the solicitation stage.

Q.2. In your statements you criticize average daily balance calculation methods that retroactively apply finance charges if a previous balance is not paid in full. As you know, one common industry practice is, that, if the previous balance is not paid in full, new charges are immediately added to the interest-bearing principal. This is called the "current charges included" variant. Am I correct in inferring that you are not criticizing this method, but rather are criticizing the practice of eliminating even the original free period, after the fact, if the balance is not paid in full?

A. 2. Yes. The "current charges included" variant has been criticized by some, but it is my impression that it is widely used and accepted. The retroactive method produces results far out of line with what a consumer would expect from normal understanding of the meaning of "average daily balance" and "free period."

Q.3. Witnesses on the previous panel suggested that requiring disclosure for all applications, including those placed on counters and inside magazines, raises practical problems and substantially increases expenses for more frequent reprinting of disclosure terms. Since you advocate covering all applications, how would you solve these problems?

A. 3. Frequent reprinting would be required only if disclosed terms changed frequently. There is much evidence that these terms do not frequently change. In any event, some credit card offerers do not find inclusion of pricing information to be a problem today. I have enclosed a copy of a counter solicitation which includes, albeit in very small print, the interest rate and annual fee for a card. I also have reviewed the mail solicitations I have received recently, and find that most include an expiration date. Counter and magazine solicitations could easily include an expiration date as well.

2  
GORTON--FOX

Q.4. What do you think about the suggestions that rather than comply with the disclosure requirements, a credit card solicitation could just enclose a copy of the contract?

A. 4. For the reason cited in your first question, I believe this would not be helpful. The contract is lengthy and contains provisions which are not factors in choices between competitors. For example, some provisions, because they are notifications of legal rights, do not vary substantially from card to card. Other provisions, such as the procedure to follow to report a lost or stolen card, are of no value until the card is in hand. Basic pricing information can be extracted from these contracts only with difficulty. Consumers comparing cards will be best served by simple disclosure of the handful of critical pricing factors, plus whatever card features offerers choose to promote.

Q.5. One witness is concerned that a grace period disclosure would give rise to a lengthy explanation of such features as the method of posting debits and credits to the account, hidden grace periods or forgiveness periods, and free-period distinctions for cash advance transactions. He argues that this explanation would complicate disclosure and limit its usefulness.

What would be an example of a "grace period" disclosure that would be useful to the consumer?

A. 5. So long as the term "grace period," or some equivalent phrase, is defined by regulation, a simple disclosure should be possible. Offerers would have the choice of following the defined practice and maintaining a simple disclosure, or of using a different practice and having to call attention to it through an explanation. A simple disclosure could read:

Grace period of 25 days after close of billing period for purchases. No grace period for cash advances."

A plain English alternative, which more clearly explains what is meant by a "grace period" might be:

"No interest is charged if you pay for purchases in full within 25 days after the bill is mailed. Interest is charged on cash advances from the date the advance is made."

3  
GORTON--FOX

Q.6. If almost all of the states have legislation defining permissible balance calculation methods, why should the federal government get involved?

A. 6. Most states do define permissible balance calculation methods. There is, however, very little standardization among the states, and many states permit two or more methods.

Federal legislation is needed because bank cards are marketed nationally, but are regulated by the law of the state in which the bank is located. A consumer who receives solicitations from banks in five states would have no way of knowing that each state has different requirements for this very technical term.

For example, according to the appendix in Credit Card Billing Practices in Virginia, these are the state laws governing bank cards in five states from which I have recently received solicitations:

Delaware: Outstanding balance may be computed by any method which does not exceed the average daily balance.

Virginia: Average daily balance OR outstanding balance on billing date OR any other balance which does not result in a charge greater than what would be charged in the other two ways.

South Dakota: None specified

California: No statutory guidelines

Ohio: The unpaid balance (including unpaid finance charges) at either the beginning or the end of the billing cycle OR average daily balance.

Even leaving aside the fact that Virginia's law appears to allow very wide variations in the meaning of "average daily balance," no consumer can be expected to know all the terms of the different states, and no consumer should be required to wade through all of the implications of these different terms in order to make a purchasing decision.



4  
GORTON--FOX**Citibank Preferred Visa Application/\$5,000-\$50,000 Credit Line****PLEASE TELL US ABOUT YOURSELF**

|                                                        |                                                                                                                                    |                                              |                                                                                                   |                                                                                                                |                                                                     |
|--------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------|---------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| First Name                                             | Middle Initial                                                                                                                     | Last Name                                    | Home Phone and Area Code                                                                          | <input type="checkbox"/> Own Home<br><input type="checkbox"/> Own Condominium<br><input type="checkbox"/> Coop | <input type="checkbox"/> Rent<br><input type="checkbox"/> Other     |
| Your Home Address, Number and Street                   |                                                                                                                                    | City, Town or Post Office                    | State                                                                                             | Zip Code                                                                                                       | Apt. No.      Years There                                           |
| Previous Home Address (if Less Than 2 Yrs. at Current) |                                                                                                                                    | Zip Code      Years There                    |                                                                                                   |                                                                                                                |                                                                     |
| Social Security Number                                 | Date of Birth (Mo./Day/Yr.)                                                                                                        | No. of Dependents (Include Yourself)         | Do you own any additional real estate?                                                            | Yes      No                                                                                                    | Years Owned      Estimated Market Value                             |
| Name of Close Friend or Relative not living with you   |                                                                                                                                    | Complete Address of Close Friend or Relative |                                                                                                   | Relative's Home Phone and Area Code                                                                            |                                                                     |
| Highest Level of Education Completed                   | <input type="checkbox"/> Grade School<br><input type="checkbox"/> High School<br><input type="checkbox"/> College Graduate Program | Major                                        | <input type="checkbox"/> Business/Accounting<br><input type="checkbox"/> Engineering/Science/Math | <input type="checkbox"/> Law<br><input type="checkbox"/> Liberal Arts                                          | <input type="checkbox"/> Medicine<br><input type="checkbox"/> Other |

**PLEASE TELL US ABOUT YOUR JOB**

|                                           |                                                                                          |                                                 |
|-------------------------------------------|------------------------------------------------------------------------------------------|-------------------------------------------------|
| Business Name or Employer                 | Check here if <input type="checkbox"/> Retired<br><input type="checkbox"/> Self-employed | If Retired, Indicate Former Employer            |
| Business Address, Number and Street       | City, Town or Post Office                                                                | State      Zip Code                             |
| Business Phone and Area Code              | Ext.                                                                                     | Employee Number      Years at Job      Position |
| If Self-Employed, Business Bank Reference | Account Number                                                                           | Type of Business                                |
| Bank Address, Number and Street           | City                                                                                     | State      Zip Code                             |

**PLEASE GIVE US SOME FINANCIAL INFORMATION**

|                                                              |                                  |                                                                                                                                                                                                                                                                                                                             |
|--------------------------------------------------------------|----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Primary Annual Income                                        | Spouse's Annual Income           | Please Note: If your annual income is below \$25,000, please indicate other sources of income that we can write to for confirmation. You do not have to include alimony, child support, spouse's annual income, separate maintenance or other income unless you want us to consider it in connection with this application. |
| Amount of Other Annual Income                                | Source(s) of Other Annual Income |                                                                                                                                                                                                                                                                                                                             |
| Monthly Rent or First Mortgage Payment (If None, List Taxes) | Maintenance Fees, if Applicable  | Monthly alimony, child support or maintenance that you pay, if any                                                                                                                                                                                                                                                          |

**PLEASE GIVE US YOUR CREDIT REFERENCES**

|                                                                                                                                                                  |                                                      |                             |                           |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------|-----------------------------|---------------------------|
| Checking Account (joint or individual)                                                                                                                           | Bank Name                                            | Account Number              | Complete Bank Address     |
| Money Market Funds, Savings Account                                                                                                                              | Account Number                                       | Amount in Program           |                           |
| CD/Treasury Bills                                                                                                                                                |                                                      |                             |                           |
| Do you own any stocks/bonds?                                                                                                                                     | <input type="checkbox"/> Yes      Estimated Value \$ | <input type="checkbox"/> No |                           |
| Do you have a Citibank Visa and/or MasterCard account?                                                                                                           | <input type="checkbox"/> Yes      Account No. (s)    | <input type="checkbox"/> No |                           |
| Do you have any of the following credit references held in your name or jointly? Please fill in the necessary information. Use an additional sheet if necessary. |                                                      |                             |                           |
| Lender                                                                                                                                                           | Estimated Monthly Payment                            | Bal.                        | Type                      |
| Citibank Visa                                                                                                                                                    | \$                                                   | \$                          | Other MasterCard/Visa     |
| Citibank MasterCard                                                                                                                                              |                                                      |                             | Personal Installment Loan |
| Carte Blanche                                                                                                                                                    |                                                      |                             | Home Improvement Loan     |
| Diners Club                                                                                                                                                      |                                                      |                             | Second Mortgage           |
| American Express                                                                                                                                                 |                                                      |                             | Other                     |

**PLEASE ANSWER THESE ADDITIONAL QUESTIONS**

|                                                                             |                                                             |                                                                                  |
|-----------------------------------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------------------------------|
| Would you like an additional card for a member of your family or household? | <input type="checkbox"/> Yes      If yes, full name of user | <input type="checkbox"/> Spouse<br><input type="checkbox"/> Other (Relationship) |
|-----------------------------------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------------------------------|

**PLEASE SIGN THIS AUTHORIZATION**

By signing below, I authorize Citibank (South Dakota), N.A. to check my credit history. If I am issued a Citibank Preferred Visa card, I authorize you to exchange information about how I handle my account with proper persons and with credit bureaus. I am aware that information gathered about me is used to determine my eligibility for this card and any renewal or future extension of credit. I am also aware that if I am approved, I will receive a credit line of at least \$5,000, and that as a cardmember, I can apply for additional credit up to \$50,000. I also desire to authorize my employer, my bank, and any other references listed above to release and/or verify information to Citibank (South Dakota), N.A. in order to determine my eligibility for the Citibank Preferred Visa card. If I ask, I will be told whether or not consumer reports on me were requested and the names of the credit bureaus with their addresses that provided the reports. If I permit my spouse to use my card, I understand that account information will also be reported to credit bureaus in my spouse's name. If it is necessary to close my existing Citibank bankcard account to qualify for the Citibank Preferred Visa card, I authorize you to do so. I understand that if I use the card or authorize its use or do not cancel my account within 30 days after I receive the card, the Citibank Preferred Visa Agreement sent to me with the card will be binding on me and that I will be responsible for an annual fee for membership of \$40. The ANNUAL PERCENTAGE RATE for cash advances and purchases is 19.8%. There is a minimum FINANCE CHARGE of 50¢ for each billing period in which any finance charge is payable.

Applicant's Signature

Date

In order to be considered for a Citibank Preferred Visa Card, you must complete and sign this application. Omission of any of the above information may delay the processing of your Citibank Preferred Visa application or be grounds for denial. Do not send payment of the \$40 annual fee; you will be billed later. Please tear at perforation, fold, seal, and mail to: Citibank (South Dakota), N.A., P.O. Box 6058, Sioux Falls, South Dakota 57117.

FOR BANK  
USE ONLY



## RESPONSE TO WRITTEN QUESTIONS OF SENATOR GORTON FROM

JERRY CRAFT

- Q.1 Mr. Craft you state in your testimony "We believe that disclosure of the APR, any annual fee, and the availability of a grace period are the crucial features influencing a consumer's choice of credit card."

Would the American Bankers Association support a bill with these features?

- A. It is general industry practice for card issuers to make these information elements available to a potential customer. Since this practice makes good business sense, we certainly do not oppose the concept. However, we also do not see a need to legislate in this area. Our great concern is that additional non-essential and confusing elements will be added to this list yielding another Truth-in-Lending mountain of confusing disclosures.
- Q.2 Mr. Fox, in his testimony, cites the same report to the Virginia General Assembly as you do, but reaches precisely the opposite conclusion: That the amount of cost variation introduced by different balance calculation methods is substantial. Would you comment on Mr. Fox's analysis? Who is it that you and Mr. Fox can reach such diametrically opposed conclusions?
- A. With all due respect to Mr. Fox's sincerity and diligence, he misstated our use of the numbers taken from the tables used in the Virginia study.

We did not misinterpret the tables as he suggested. As our testimony indicated, the numbers we referred to from the study fairly represent the variations resulting from actual average daily balance calculations. Because the issue was the average daily balance calculation itself, what they did not take into account, which we did not intend that they take into account, was the effect of the use and availability of free periods.

That is an entirely different issue that the Virginia study specifically addressed which neither the bills nor the hearings nor our testimony intended to address. His allegation takes our testimony out of context.

Mr. Fox seems to think that we overlooked the fact that according to the finance charge computation explanation for Bank A, interest was charged on a balance twice the others (\$810 compared to \$437.96 and \$424.03). We are neither ignorant nor concerned with that result insofar as, in simplest terms, this figure, \$810, represents the sum of the average daily balance of two months (so thus is about twice as large), not a simple, one month average daily balance. It has nothing to do with the method of calculation of the average daily balance. It

2  
GORTON--CRAFT

is true, as Mr. Fox said, 810 is about twice 400, but what Mr. Fox fails to recognize is that this result is due to a practice rather unique to Virginia, whereby a finance charge interest is imposed retroactively the first time a nonrevolver does not pay the balance in full.

Under the Virginia law, creditors are required to give customers a 25 day interest-free period. However, if the balance is not paid in full by the due date, the creditor may retroactively impose a finance charge against those charges made during that prior period, thus, in effect, eliminating the initial interest-free period for debits made during that prior month.

Although this causes a higher finance charge for the first month that a nonrevolver becomes a revolver (that is, the first month when balance is not paid in full) because it represents two months interest, this apparently higher finance charge is a one time occurrence; of course in subsequent billing periods, interest is paid only on the average daily balance of one month.

The table of the Virginia study shows that in that particular scenario, it was assumed that the customer started with a 0 previous balance. Thus, for Bank A, when the customer did not pay in full at the end of the first month, interest is charged on the sum of the average daily balances of two months ( $\$383.48 + \$426.52 = \$810.00$ ). The other two banks do not impose finance charges retroactively, so naturally they charged only on the second month's average daily balance. This accounts for the result that Bank A appears to calculate an average daily balance twice that of the other two banks - but only for that first "revolving" month.

Once again, the disparity is due to the effect of eliminating the free period when an account is not paid in full at the end of the period, and not to the method of calculating the average daily balance per se.

This practice is one that is rather unique to Virginia due to the law mandating free periods. It was an issue addressed by the Virginia legislature in the last legislative session when it was decided that nothing should be changed. However, it was properly not the subject of the hearing or bills of this Subcommittee so was not addressed by ABA.

Q.3 Most of you have testified in favor of limiting disclosures to card solicitations MAILED to the customer. This would exclude the "take-one" or "pick me up" applications found at counters and in magazines. One witness explained that the problem with requiring disclosures for the "take ones" is that each time any disclosure term changed, the issuer would have to revise and reprint all forms.

- a. How often do issuers now revise and reprint forms?
- b. Why couldn't issuers have a disclosure stating that the terms are applicable until a certain date?

- A. a. How often issuers revise and reprint forms varies from issuer to issuer, as does the number of forms distributed. Some banks may distribute several thousand forms that may remain in one place for as long as four years. Others may restrict the number and locations of distributions and thus reprint and revise more frequently. How often forms are replaced will vary depending on where they are located, how quickly they run out, and whether the issuer chooses to continue the distribution and replacement of such applications.

An additional practical consideration and hardship of revising and reprinting forms is the physical process of retrieving and then replacing them. It is not unimaginable that an issuer might be unsure about the location of all forms. Certainly, for those issuers with wide dissemination, such a task might inhibit placing them so broadly. But even issuers that limit distribution would find locating all forms a somewhat awesome task.

It might also be useful at this point to clarify an assumption that has been made that most credit card applications are in response to "take-ones." This is not necessarily true. How many applications are derived from "take-ones" will vary significantly from bank to bank and will depend on numerous factors including what other promotion efforts such as solicitation, the bank employs and when it employs them. For instance, according to Jerry Craft, Senior Vice President of the First National Bank of Atlanta, fewer than 20% of credit card applications at his bank are derived from "take-ones." In fact, since the 1960's, over half are in response to solicitations. Other banks may use no other kind of marketing tool other than "take-ones" so their "take-one" response would obviously be higher overall.

- b. Our objection to requiring a statement that terms are only applicable until a certain date are related to the same costs associated with requiring disclosures on "take-ones": the cost of reprinting, retrieval, and redistribution. If the terms are only valid up to a certain date, they are no longer usable by customers after that date and thus must be replaced by fresh "take-ones" that the customer may use. The forms would have to be replaced by that date even when the terms have remained the same. Again, this process would require printing new forms with the new dates, retrieving old forms, and replacing them with new ones.

The costs associated with this constant replacement creates a most inefficient means of promotion that may deter issuers, particularly those with limited marketing resources, from employing this promotional technique. Simple means of promotion thus becomes expensive and complex and therefore of more limited value to the issuer.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GORTON FROM  
RALPH ROHNER

CONSUMER  
BANKERS  
ASSOCIATION

an association for the  
retail banking professional

July 8, 1986

The Honorable Slade Gorton  
United States Senate  
Committee on Banking, Housing  
and Urban Affairs  
513 Hart Senate Office Building  
Washington, D.C. 20510

Dear Senator Gorton:

After the May 21 hearing on credit card disclosures and balance computation methods, you submitted some further questions and requested answers on behalf of the Consumer Bankers Association, Visa U.S.A. Inc., and MasterCard International, Inc. Our responses follow. For ease of reference we have repeated each question immediately before our answer.

QUESTION #1: On page 20 of your statement you say, "Any required disclosure . . . should be limited to the annual percentage rate and annual fee." But on page 26 you say, "if any disclosure legislation is adopted, card issuers should be required to disclose at most, only (annual percentage rate, annual fee, and grace period)." What is CBA's position?

ANSWER: Our position continues to be that no special credit card disclosure legislation is justified at this time. Our testimony also suggested two fallback positions. First, if a disclosure bill is enacted at all, it should emphasize those basic items that can be simply disclosed by the creditor, can be compared by the consumer, and will most directly influence the consumer's cost and thus the threshold choice of whether to apply for a card. In our view, these items would be the Annual Percentage Rate and Annual Fee. The effects of other possible

2  
GORTON--ROHNER

charges, because of the enormous variations in patterns of customer use of the card, are so uncertain that advance disclosures are not likely to influence the initial decision to apply. In any event, and this is our second fallback, no legislation should require solicitation disclosures beyond the APR, annual fees, and some succinct statement about grace periods. Any more detailed disclosure, at the pre-application stage, would require narrative descriptions of charges that vary, depending upon individual use habits, are certain to occur, and are subject to change.

QUESTION #2: You state (p.34) ". . . some retailers, like some banks, export credit card terms . . ." across state lines. I thought this was generally prohibited. Would you give me a specific example of this, please?

ANSWER: While retailers do not enjoy the same "most favored lender" status accorded to banks under federal law (which some banks rely on to export credit card terms), retailers may still be free under state "choice of law" principles to contract for home-state rates and terms. This ability to choose the state law that will govern their customer contracts is often used by mail-order retailers and retailers operating in multi-state markets. With respect to interest charges in particular, the prevailing rule in the states, reflected in the Restatement (Second) of Conflict of Laws § 203, is as follows:

The validity of a contract will be sustained against a charge of usury if it provides for

a rate of interest that is permissible in a state to which the contract has a substantial relationship and is not greatly in excess of the rate permitted by the general usury law of the state of the otherwise applicable law . . .

A rule similar to this was recently applied to permit a retailer in Tennessee to charge Tennessee rates to an Arkansas customer despite lower rate ceilings in the borrower's home state. Stacy v. St. Charles Custom Kitchens of Memphis, Inc., 683 S.W. 2d 225 (Ark. 1985)

The distinction between banks and retailers fades even further when one recognizes that some retailers may actually extend credit through banks that are affiliated with the retailer through either direct or common ownership or control. We would note in particular that the Sears Discover Card is actually issued by a Delaware bank, which is in the Sears corporate group. The phenomenon is not limited to retailers, but includes the "travel and entertainment" card issuers as well: lines of credit in the American Express Gold Card program are in some cases issued by banks in the American Express corporate family.

QUESTION #3: Would you explain precisely what the "actuarial" balance calculation method is, and how it differs from the average daily balance method?



4

GORTON--ROHNER

ANSWER: The "actuarial" or "daily balance" method of computing finance charges refers to a system that applies a daily rate to the balance in the account each day and totals these daily finance charge figures for the billing period. In contrast, the "average daily balance" systems generally calculate an average balance for the month and then apply a monthly rate factor. For example, consider an account where the annual percentage rate is 18%. Under the actuarial method, the creditor would apply a daily rate factor of .0004932 (.18/365) to the balance in the account at the beginning or end of each day, and add these daily dollar (or cents) totals to produce the finance charge for the month. An average daily balance system instead would apply a monthly factor of .015 to a single averaged balance.

The actuarial method is more precise, but the yields it produces are not dramatically different from those produced by an average daily balance method. Under the latter the consumer pays a little more than he should in February (a short month) but gets a little break in months with 31 days; under the actuarial method each day's balance is treated identically, so there is no skewing from month to month.

We believe that it would be somewhat anomalous to require the marginally-imprecise average daily balance method when more refined methods exist, and that there would be significant software conversion costs for creditors who would have to re-program from an actuarial to an average daily formula.

QUESTION #4: Several of you oppose disclosure of "other charges" and say only the annual fee should be disclosed. However, Mr. Craft suggests that all charges that will be applied consistently to the account, such as transaction fees, be disclosed. This approach would exclude charges for (what he suggests are) abusive and abnormal use of the card, like late payments, bad checks, card replacements, and overlimits.

Would you comment on this proposal?

ANSWER: First, while we cannot speak for Mr. Craft, we are not certain that his recommendation included the disclosure of transaction fees. He suggests at page 3 of his testimony that any disclosure should be limited to "the APR, annual fee, and the availability of a grace period."

5

GORTON--ROHNER

To the point of your question, we would oppose mandatory disclosure of "all charges that will be applied consistently to the account, such as transaction fees," for several reasons. First and foremost, we are talking about disclosure at a pre-application stage where it is simply impossible to know which charges will in fact be consistently applied. Some consumers may regularly incur transaction charges for cash advances, while other customers may use the card for ATM transactions for which a different fee structure applies. It is the nature of these charges that they depend on the customer's use patterns which cannot be discerned in advance. The suggestion thus begs the question of exactly which charges should be so disclosed.

Our second objection is that any attempted disclosure of these charges would inevitably require narrative descriptions of the type of charge and when it would be imposed, thus cluttering what is intended to be a simple "price tag" solicitation disclosure. Moreover, it bears repeating that the customer will get all that information, and more, no later than when the card is sent; a consumer who wants to identify all possible use patterns and their cost consequences can do so at that time.

QUESTION #5: Most of you have testified in favor of limiting disclosures to card solicitations MAILED to the

6  
GORTON--ROHNER

consumer. This would exclude the "take one" or "pick me up" applications found at counters and in magazines. One witness explained that the problem with requiring disclosures for the "take ones" is that each time any disclosure term changed, the issuer would have to revise and reprint all forms.

How often do issuers now revise and reprint forms?

Why couldn't issuers have a disclosure stating that the terms are applicable until a certain date?

ANSWER: We have no data on how often card issuers revise and reprint forms, particularly the countertop "take one" applications or brochures. If compelled by law to put explicit cost terms in such brochures, or in magazine ads, most card issuers would probably want to put an "effective" or "expiration" date along with those disclosures for their own protection.

With all due respect, however, the questions seem somewhat misfocused. One or another of the terms of a credit card plan may change with some frequency, given the volatile nature of the market. At present, reprinting of forms or brochures may not be necessary for each such change if the existing materials are still usable as general promotions. But if specific, current disclosures are required in each brochure, a change in terms for the plan would necessitate the reissuance and redistribution of that brochure. Thus a disclosure provision applicable to such "general public" solicitations would greatly compound a card issuer's promotional costs.

7

GORTON--ROHNER

Even with a stated expiration date, "stale" brochures or materials will inevitably get into the hands of consumers who may overlook that statement and then claim to be misled by the outdated disclosures.

Moreover, since the rate at which consumers use "take-one" brochures and applications varies significantly from site to site, making it difficult to predict inventory replacement schedules, card issuers would need to establish internal units or employ external service organizations, to monitor and recall applications and brochures with each change in terms. Thus, the costs of recalling outstanding applications and brochures would be high.

**QUESTION #6:** In your testimony you state that "the value of legislation imposing additional and duplicative disclosure requirements must be considered in light of the potential for consumer confusion and information overload . . ."

In what sense are these bills duplicative?

What other statutes require disclosure of the annual percentage rate, annual fees, and grace period in credit card solicitations?

**ANSWER:** The pending bills are duplicative of existing requirements of the Truth-in-Lending Act in two respects. First, consumers will get all the information required by these bills no later than the actual issuance of the card. This is currently required by TIL Act § 127(a) and Regulation Z §§226.5 and 226.6. Second, any

8

GORTON--ROHNER

creditor who voluntarily incorporates the annual percentage rate, annual fees or grace period into advertising materials must then also include additional pertinent cost information. This is the thrust of TIL Act § 143 and Regulation Z §226.16.

We did not mean to infer that other existing laws already require specific numerical or textual disclosures at the solicitation stage. We would note, however, that many states have laws prohibiting unfair or deceptive acts or practices, and these statutes could be brought to bear on promotional or solicitation activities that constitute real deception.

QUESTION #7: Several of you have warned against "lengthy" and "complex" disclosure requirements. Do any of you think that a requirement to disclose the APR, annual fee, and grace period is lengthy and complex?

ANSWER: The Gorton Bill as presently drafted also calls for disclosure of "other charges . . . applicable to the . . . use of the credit card." As we made clear in our testimony, we would prefer any disclosure requirement to be limited, as suggested by this Question 7, to the annual percentage rate, annual fee and a simple grace period (or "free period") disclosure. Certainly a disclosure of the APR and annual fee need not be lengthy. Disclosure about grace periods could become quite lengthy if the disclosure had to explain all the varying circumstances under which pre-billing and post-billing grace periods could exist.

9  
GORTON--ROHNER

This is why we urged in our testimony that any such grace period disclosure be limited to purchase transactions, and be based on the simplest possible statement as to the grace period.

QUESTION #8: You note that a requirement for a uniform balance computation method would conflict with state laws, and creditors could be required to run parallel systems to accommodate mandated changes. Could you tell us how many state statutes would be conflicting?

ANSWER: We do not have such a nationwide compilation at hand. We note, however, that the appendix to the testimony of the National Retail Merchants Association collects the balance computation rules applicable to merchants. We believe that the rules for bankcards are equally as diverse, and in many cases may be covered by the very same provisions the NRMA lists.

In some states, this conflict between a federally mandated "average daily balance" method and local state law would be quite clear. For example, North Dakota requires any credit service charge to be disclosed in the intital agreement as a "monthly rate to be applied to the balance outstanding from time to time . . . as of the beginning or end of each billing period." N.D. Cent. Code § 51-14-02. As importantly, many states require the use of carefully defined "average daily balance" methods which vary from state to state. This would necessarily lead to state definitions which differ from a Federal Reserve Board



10  
GORTON--ROHNER

definition of the "average daily balance." See, e.g.  
Tex. Rev. Civ. Stat. Ann. art. 5069-15.01(c); Me. Rev.  
Stat. Ann. tit. 9-A § 2-402(2).

The costs associated with maintaining dual systems are quite substantial. There are, of course duplicative hardware and software expenses once two systems must be used. Additionally, there are significant legal and design costs associated with running two systems. For example, it is not clear how payments and credits, or how insurance premiums, are allocated. These problems become more complicated when one recognizes the possibility that different rate and balance computation methods would be used in each system.

Regardless of the number of outright conflicts, a larger point remains. The states typically incorporate balance computation methods as part of a comprehensive regulatory scheme for consumer credit. Federal tinkering with one element of those schemes not only intrudes on what have been state prerogatives, but risks upsetting what are often delicate balances of restrictions and permissions for rates, balance methods, annual fees, incidental charges, and other aspects of credit programs.

Sincerely,

Ralph J. Rohner  
Special Counsel

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM  
RALPH ROHNER

CONSUMER  
BANKERS  
ASSOCIATION

an association for the  
retail banking professional

June 16, 1986

The Honorable Alfonse M. D'Amato  
United States Senate  
Committee on Banking, Housing  
and Urban Affairs  
520 Hart Senate Office Building  
Washington, D.C. 20510

Dear Senator D'Amato:

After the May 21, 1986 hearing on credit card disclosures and balance computation methods, you submitted some further questions and requested answers on behalf of the Consumer Bankers Association, Visa, U.S.A., Inc., and Mastercard International, Inc. Our responses follow. For ease of reference we have repeated each question immediately before our answer.

QUESTION #1: Despite your arguments to the contrary, you cannot cite any evidence that the free market is working. By contrast, I can cite the lack of price competition among the 10 largest issuers and the fact that the profit on credit card activities is 5 times higher in 1985 than all other bank lending activities. This fact suggests the free market isn't working yet you still oppose additional disclosures. I am curious, just how do you propose to make the free market work if consumers are denied easy access to information that will enable them to comparison shop?

ANSWER: Our perception of the market differs fundamentally from yours. There is also abundant evidence of vigorous and healthy competition among credit card issuers, including the fact that credit cards have never been more popular among consumers, and more and more card issuers are marketing their card plans to an increasingly sophisticated public. Direct price competition has never been the sole benchmark of a successful "free market" (witness the present pricing practices of the automobile

2  
D'AMATO--ROHNER

industry). In any event there is daily evidence in the press and elsewhere that competition for credit card customers is being cast in price terms. The attached article which appeared in the June 5 issue of the American Banker refers to a credit card "rate war" in Connecticut, the enclosed advertisement touts one local card issuer's low rates, and the attached copy of the Nilson Report for April 1986, lists (p. 7) some 23 banks that have reduced their rates over the preceding year.

Our opposition to the pending bills is not based on any fear of free market competition, nor on a desire to withhold relevant information from the consuming public. Our objection is to the imposition of a new layer of specific, rigid, burdensome disclosure requirements on top of existing federal disclosure laws that have worked successfully since 1969.

QUESTION #2: In your testimony I am not sure whether you feel additional disclosure is unnecessary because customers do not really want this information or because additional disclosure will confuse consumers and therefore not provide any new information to which the customer already has access?

ANSWER: Neither reason reflects our position. We accept the fact that many consumers want to know about the cost implications of credit card programs. However, we believe that the interests of these consumers are not furthered by additional disclosures which may well confuse rather than enlighten them. Our position on this issue is

3

D'AMATO--ROHNER

straightforward: consumers who want information can get it now -- from advertisements, by telephone inquiry, and as part of the initial disclosures given before the consumer is in any way obligated on the account. A new regimen of mandatory written disclosures in all solicitation and application materials, with the attendant costs and compliance risks for creditors, cannot measurably improve the existing information available to consumers about credit cards.

QUESTION #3: In your testimony you state that additional disclosure is "duplicative and unnecessary" and cite a 1977 report that concluded a majority of consumers were aware of credit card interest rates. Believe it or not, a lot has changed since 1977. The number of credit card users has increased dramatically, credit balances are increasingly high so that we have become a nation of credit card junkies; however, the ability of the consumer to comparison shop among the many new entrants in this field is limited due to a lack of disclosure. How can you say that increased disclosure and dissemination of information to the public is unwarranted and the public is aware in light of the fact that I have received, since January 28, 1986, over 100,000 inquiries concerning the availability of low cost credit? Certainly there are better ways to disseminate this information to the public than through Congressional offices.

ANSWER: Our testimony was to the effect that existing disclosure laws have had a dramatic effect on consumer rate awareness, even measured as of 1977. Ongoing studies by the Federal Reserve Board and others promise to shed further light on the dynamics and the effectiveness of existing disclosure mechanisms. Hasty enactment of new disclosure rules, without the benefit of the fullest possible empirical information, such as the current Federal

Reserve Board study scheduled to be available in the Fall, may be nothing more than a shot in the dark to solve a "problem" that may not really be there at all.

Without being privy to your correspondence, we cannot comment knowledgeably on the "inquiries" you have received. We are inclined to believe, however, that they are testimony to the widespread and effective publicity you and other members of Congress have given to credit card rate matters, publicity that has certainly increased the sensitivity of both consumers and card issuers to competitive rates.

QUESTION #4: In the current economic environment of lower consumer interest rates, lower prime rates and lower discount rates, why have credit card interest rates remained so relatively high?

ANSWER: There are numerous reasons why credit card rates do not always track major economic indices: these include the relatively less significant role of cost-of-funds in setting credit card prices; the unique services offered through credit cards; the high transaction volume and intensive data communications that characterize credit card programs; and the need to maintain profitability after periods when credit cards were "loss leaders." We commented extensively on these matters in a January 28, 1986, letter to Senator Gorton, a copy of which is attached for your information.

5

D'AMATO--ROHNER

QUESTION #5: Many credit card issuers claim that servicing costs necessitate the charging of the current high rates.

- a) What portion of current interest rate charges are used to finance servicing costs?
- b) What percentage of interest rates is comprised of the cost of funds to card issuers?
- c) If the cost of funds drops precipitously, then shouldn't credit card rates also drop accordingly?
- d) If the cost of funds has a significant impact on credit card interest rates, and the cost of funds has dropped, then servicing costs must have increase exponentially to justify the charging of interest rates exceeding 19%? Have servicing costs risen during the last 4 years or have they remained steady?
- e) If servicing costs justify current credit card interest rates, then how can a small bank in Arkansas which charges 12.5% be more efficient at servicing its card holders than large institutions such as the Bank of America and Citibank which charge their card holders rates in excess of 19% and sometimes 21%?
- f) If more consumers are aware of banks charging lower rates, and the high rate chargers begin to lose customers to these banks, wouldn't Citicorp and Bank America be compelled to lower their card rates?
- g) Wouldn't the lowering of interest rates by the high rate chargers in response to increased competition represent an admission that the failure of credit card interest rates is due to a lack of competition between issuers rather than rising servicing costs?

ANSWER: Since the setting of credit card rates and terms is a matter for each card issuing institution, neither CBA nor the Visa or MasterCard organizations maintain pricing data on individual bank card programs. We have attached the April 1986 Nilson Report which (pp. 4-5) gives



6  
D'AMATO--ROHNER

useful breakdowns of bankcard expenses and income, which we refer to in response to your specific inquiries.

a) According to the Nilson data, 55% of the expense of a card program goes to items other than the cost of funds. Interest charges amount to 63% of the card issuers' income. As a percent of interest income alone, operating costs would be 69%.

b) Nilson projects cost of funds as constituting 44.96% of the total expense of operating a bank card program. As a percent of interest income alone, the cost of funds would be 56.5%.

c) Certainly rates would not drop immediately, and perhaps not even in the longer term, if card issuers face increasing operating costs, or are rebounding from prior periods of negative profitability (such as was generally the case in 1980-81 and some earlier periods).

d) We have no comparative data on servicing costs over the past four years.

e) The ability of a small bank in Arkansas to offer lower rates than a money center bank does not hinge on "efficiency." It is the result of targeting only a very selective, "blue chip," customer base, localized

7  
D'AMATO--ROHNER

operations, and the generation of income from non-rate sources such as annual fees, reduced grace periods, higher merchant discounts, and the like. (We note that one Arkansas bank that has shared in your praise for its particularly low rates is now planning to relocate its credit card operations to Delaware, a state which has deregulated rate ceilings presumably for the purpose of exporting rates).

(f) If it were clear that a loss of customers was attributable to competitors' lower rates, it is plausible that banks would reduce their own rates as a competitive reaction. Since all available evidence suggests that customer loyalty is related to numerous factors beyond just rate, a mass exodus of customers from one bank card program to another is unlikely. For example, Nilson estimates that 51% of all card holders are "convenience users": i.e., they pay off their balances within the grace period and thus avoid all finance charges. There would be no incentive for these customers to change banks merely because of a lower rate; indeed there would be a positive disincentive to change banks if the lower-rate card plan restricted or eliminated grace periods.

g) No. In our view it would demonstrate exactly the opposite, namely that as circumstances permit some banks to lower rates, other banks may feel compelled to adjust their

8  
D'AMATO--ROHNER

rates as well. This is the competitive market place at its best.

QUESTION #6: Doesn't the failure of credit card interest rates to fall reflect the ability of card holders to charge these rates due to the state-established statutory ceilings on interest rates rather than the overall costs function of credit card interest rates?

ANSWER: No. It has been amply demonstrated theoretically, and more importantly empirically, time and time again that credit charges ebb and flow with market pressures, operating expenses, and alternative investment opportunities, and that artificial state-law restrictions on rates either force creditors to generate revenue from other sources, or discontinue or reduce lending in that restricted market.

QUESTION #7: Does the demand for credit cards explain the failure of interest rates to fall? Have credit card issuers responded to falling financial costs by increasing the availability of credit cards rather than lowering card rates? Haven't card issuers chosen to compete by easing their credit standards or by making non-rate credit terms more attractive rather than by lowering interest rates? If real competition existed between credit card issuers then would card rates drop?

ANSWER: We are not certain we follow the thrust of this sequence of questions, nor that we have the data to answer them precisely. Intense competition for profitable customers has clearly increased the overall number of cardholders significantly. The techniques that individual card issuers use to attract and hold their customers are probably so varied and mixed as to defy generalizations.

9

D'AMATO--ROHNER

Banks in general have not thought it their duty to ration credit card services to only the affluent.

QUESTION #8: Would the imposition of a floating rate ceiling cause credit card issuers to be more reluctant to ease their credit card standards? Could this result in the extension of credit to some individuals? Wouldn't they be less likely therefore to extend credit to those who are not credit worthy rather than to discriminate against those with acceptable credit histories? Doesn't this mean that card issuers are willing to keep rates high for responsible users while simultaneously lowering credit standards to disseminate more cards to the general public without regard to credit worthiness?

ANSWER: A restrictive floating rate ceiling would undoubtedly cause many banks to tighten their credit granting standards to minimize collection problems and the risks of default. The inevitable effect would be to deny the benefits and convenience of credit cards to those consumers whose incomes or other creditworthiness credentials are marginal. This kind of rationing is not an objective that banks wish to pursue, and we believe it runs directly counter to prevailing federal policies on credit availability and community reinvestment.

In fact, making credit available to lower income levels often results in very large net social gains. As an example, consider the family which cannot afford to pay cash for a washing machine, and therefore substitutes the use of the landromat. One can easily imagine that the costs incurred (lost time, travel expense and higher per load charges) exceed the interest expenses associated with

10  
D'AMATO--ROHNER

the purchase on credit of a washing machine. Thus, we would suggest that card issuers are providing a beneficial product when they are able to offer credit cards to persons other than the "blue-chip" card user since, on balance, credit purchases can often lead to a net savings for lower-income families.

On the other hand, it is not correct to state or assume that card issuers now issue credit cards "without regard to credit worthiness," or to "those who are not credit worthy." Similarly, it is not the case that bank card issuers "discriminate against those with acceptable credit histories."

QUESTION #9: In recent months we have heard conflicting reports concerning the reasons credit card rates have not declined. Shouldn't we require an independent agency of the federal government to provide an explanation of the failure of rates to fall? What agency should undertake such a study?

ANSWER: We seriously doubt that an investigation by a federal agency would add any further enlightenment to what your Committee has gathered over the several recent sets of hearings.

QUESTION #10: Why shouldn't some issuers lower their rates to increase competition rather than to issue more credit cards to a broader general public?

ANSWER: Our understanding of current law and policy is that a bank card issuer should be free to pursue either goal, or both simultaneously, subject only to constraints

11  
D'AMATO--ROHNER

of fair dealing, non-discrimination, and safety and soundness.

QUESTION #11: On average, how many points above the cost of money do banks need to make a profit on their credit card operations?

ANSWER: The attached Nilson Report (p. 7) suggests that "the spread between the effective rate that determines income and the cost of money should be within the 6%-8%" range, as it was in 1985.

QUESTION #12: Can you cite any evidence that credit card interest rates will drop in the near future unless we enact legislation?

ANSWER: See our answer to Question 1 and the attachments thereto.

QUESTION #13: The states of Washington, Arkansas, Alaska and Texas have imposed some types of limitation on credit card interest rate charges. What have been the experiences of credit card issuers in these states?

ANSWER: To the best of our knowledge, in those states and elsewhere when rates are limited, card issuers adjust in some combination of the following ways: (1) increase annual fees, merchant discount, or other charges; (2) tighten credit granting standards to maintain an up-scale customer base; (3) lower the credit limits or terminate the cards for marginal customers; (4) relocate their credit card programs to a more hospitable state and "export" more favorable rates; or (5) shut down their credit card program or sell it off to an out-of-state competitor. These



12

D'AMATO--ROHNER

effects can be empirical by various studies, copies of which we would be happy to provide.

QUESTION #14: Let's assume that the floating ceiling contemplated by the D'Amato bill, S. 1922 was imposed upon banks. How would this affect the banks -- would they be able to make a profit or would the less profitable be forced out of business?

ANSWER: See the answer to Question 13.

Sincerely,

Ralph J. Rohner  
Special Counsel

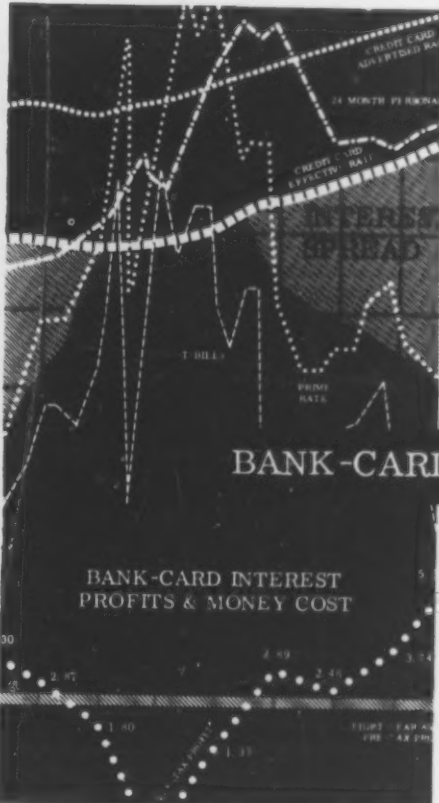
MONTH  
APRIL  
1986

# THE NILSON REPORT™

ISSUE  
378

A PRIVATELY PUBLISHED TWICE-MONTHLY NEWSLETTER AND ADVISORY SERVICE FOR CREDIT-CARD EXECUTIVES

**THE TRUTH ABOUT BANK-CARD PROFITS.** Last year's impressive earnings were a relatively new phenomenon for U.S. bank-card issuers who are now being accused of making too much money from too high interest rates. Law-makers and consumer advocates leading the attack with a variety of proposals to regulate bank cards may think they are pursuing the best interests of consumers, but they're wrong and the industry isn't offering any convincing arguments about what the damaging effects would be.



**BANK-CARD PROFITS** (Continued from page 1)...and unfairly channel less expensive credit to higher-income (lower risk) market segments that need it least... The interest rate advertised to cardholders is always higher than the "effective" rate that produces bank-card income... Price controls designed to protect consumers from monopolies are not appropriate for regulating the bank-card industry which isn't a monopoly.

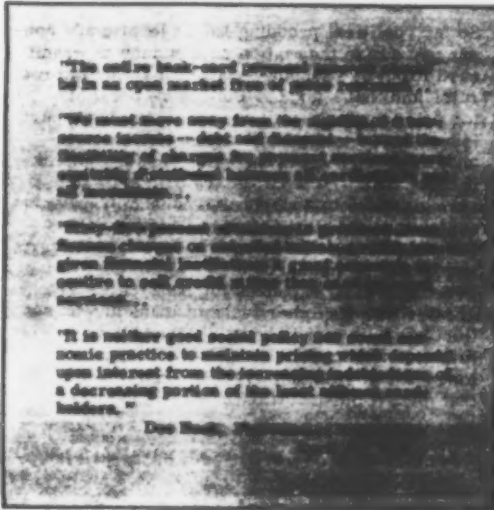
**Bank cards give consumers access to the world-payment system.** Bank cards and, to a lesser degree, American Express have been the major players in building a world-payment system that offers a substitute for cash and checks. In the U.S., depository institutions that belong to the Visa system issue 58% of all bank cards while MasterCard which also licenses most of the same institutions to use their service mark has a 42% share. Cards issued for both systems are honored at 4.8 million establishments worldwide including 2.2 million in the U.S.

Bank cards are issued to a broad base of creditworthy customers totalling 71.6 million in the U.S. and 147.5 million worldwide. American Express has 17 million in the U.S., 23 million worldwide and is honored at 600,000 U.S. establishments. Only one in every 17 bank cardholders qualifies for an American Express card. Their Platinum version is issued by invitation only to customers that run up charges of \$12,000 or more annually.

Sears hopes to become a major player in the United States with its new Discover card but so far has less than 250,000 in circulation honored at 200,000 establishments in major market areas. Diners Club and Carte Blanche, both owned by Citicorp, have less than 1.7 million in the U.S. combined including

private-label cards for Amoco (Torch Club) and Sunoco (Sun Diners). Outside the U.S., Citicorp operates a few franchises issuing about 900,000 cards and 36 Diners Club franchises which are independently owned have issued an additional 2 million for a total of 4.6 million cards. JCB which is Japan's major credit card with 7 million customers is expanding coverage to all countries frequented by Japanese travelers. EuroCard (affiliate of MasterCard) and Eurocheque serve the European market exclusively.

There are 1.1 billion credit cards of all kinds circulating in the world today of which 721.1 million are in the U.S. as follows: Proprietary cards totalling 541.2 million (75%) are issued by oil companies, airlines, auto rentals, telephone companies, department stores and other retailers... the remaining 25% are general-purpose cards issued by travel and entertainment companies, banks and Sears. Banks account for only 22% of all credit cards, yet they handle over 41% of all spending and 58% of all credit-card debt. In addition to credit cards, banks have issued 135



million debit cards. The combination gives consumers access to 175,000 automated teller machines globally plus over 100,000 point-of-sale terminals that directly debit funds on deposits. Banks are supporting two separate systems for handling credit authorization and funds transfer worldwide and the cost of installing and maintaining the required telecommunications and terminals and computer centers is largely funded by finance charges on credit-card loans.

**Bank-card loans are unique.** They are not comparable to commercial loans or to loans for larger amounts, or to short-term or secured loans or to those with fixed payment schedules and termination dates. They are smaller and therefore more costly to execute. They are unsecured and can be drawn on impulse without an on-the-spot credit check. They have instant authorization, are repaid on a flexible schedule determined by the cardholder, and are extended to a broader segment of society than any other kind of consumer loan.

One of the least publicized but greatest consumer benefits of using a bank card is after-the-fact recourse for transaction disputes involving questionable or misrepresented merchandise and services.

Everyone using a bank card creates a loan of some kind, but only 67.8% of accounts active in any one month (72% of total accounts) are using revolving credit. Applied to the total customer base, that means 48.8% are revolving users. The remaining 51.2% are convenience users who pay up during the free grace period and don't incur finance charges even though they get interest-free loans from 15 to 59 days. Revolving accounts maintain average balances of \$1,172. Because the average customer has more than one card, the outstanding debt on credit cards for cardholders who maintain balances is \$1,625. The average revolving credit-card loan is paid off in 16.5 months.

Convenience users are not, as some say, subsidized by loan customers who pay all the interest. They can be and often are the same people, sometimes paying in full and sometimes paying the minimum to carry an unpaid balance but always able to choose. Both types of use are necessary to make the total bank-card payment system operate efficiently for cardholders and participating merchants.

**Credit-Card Interest and Fluctuating Money Costs.** There is no good rationale for comparing the prime rate banks charge their best corporate borrowers with whatever rate they charge their credit-card customers. Neither does bank-card interest have any direct relation to commercial loans, secured loans, three-month Treasury bills, etc. The most appropriate rate to use in connection with bank-card rates is the one for 24-month personal loans which has generally run higher than the effective rate for bank cards as shown on next page.

**Advertised Rates vs. Effective Rates.** The average finance charge to U.S. cardholders is currently 19.37%. But allowing for 16% of outstandings generated by customers who pay up within the grace period without incurring finance charges, the reduced "effective" rate that produces income is 16.35%.

### BANK CARDS WOULD LOSE MONEY If All Consumers Used Them Efficiently

At current rates, banks are losing \$1.2 billion annually if the 51.2% of cardholders who use bank cards efficiently (paying up during the free grace period) were to use them as revolving users. This would mean an additional \$1.2 billion in interest income for banks. The average revolving credit-card loan is paid off in 16.5 months.

### BANK CARD ADVERTISED RATE Compared to EFFECTIVE RATE

| Advertised Rate | Effective Rate |
|-----------------|----------------|
| 13.32           | 19.37          |
| 14.00           | 20.00          |
| 15.00           | 21.17          |
| 16.00           | 22.33          |
| 17.00           | 23.50          |
| 18.00           | 24.67          |
| 19.00           | 25.83          |
| 20.00           | 27.00          |

|       |       |
|-------|-------|
| 19.37 | 28.17 |
| 20.00 | 29.33 |
| 21.17 | 30.50 |
| 22.33 | 31.67 |
| 23.50 | 32.83 |
| 24.67 | 34.00 |
| 25.83 | 35.17 |
| 27.00 | 36.33 |

### HOW BANK CARDS MADE MONEY IN 1985

| % of Out-standings | Source                      | Amount      | % of Total |
|--------------------|-----------------------------|-------------|------------|
| 16.35%             | Interest Charges (@ 18.37%) | \$1,000,000 | 11.1       |
| 4.85%              | Nr. Merchant Income         | \$300,000   | 3.3        |
| 2.69%              | Annual Fees (@ \$18.51)     | \$500,000   | 5.6        |
| 1.83%              | Other Fees/ Penalties       | \$115,000   | 1.3        |
| 25.02%             | Total                       | \$2,915,000 | 32.3       |

### INCOME

| % of Out-standings | Source                         | Amount      | % of Total |
|--------------------|--------------------------------|-------------|------------|
| 9.24%              | Money                          | \$580,000   | 6.5        |
| 2.19%              | Credit Losses                  | \$135,000   | 1.5        |
| 1.94%              | Merchant Sales & Servicing     | \$120,000   | 1.3        |
| 1.25%              | Advertising & Promotions       | \$78,000    | .9         |
| 1.24%              | Credit Reprints & Processing   | \$77,000    | .8         |
| 1.31%              | Statement Billings             | \$82,000    | .9         |
| 0.67%              | Cardholder Services            | \$42,000    | .5         |
| 0.55%              | Collection & Overlimit Control | \$34,000    | .4         |
| 0.47%              | Fraud Losses                   | \$29,000    | .3         |
| 0.47%              | Fraud Investigation            | \$29,000    | .3         |
| 0.32%              | Via a MasterCard Fee           | \$20,000    | .2         |
| 0.29%              | Card Issuing                   | \$18,000    | .2         |
| 0.24%              | Credit Authorization           | \$15,000    | .2         |
| 0.19%              | Enrollment                     | \$12,000    | .1         |
| 30.55%             | Total                          | \$1,915,000 | 21.4       |

### EXPENSE

| % of Out-standings | Source                         | Amount      | % of Total |
|--------------------|--------------------------------|-------------|------------|
| 9.24%              | Money                          | \$580,000   | 6.5        |
| 2.19%              | Credit Losses                  | \$135,000   | 1.5        |
| 1.94%              | Merchant Sales & Servicing     | \$120,000   | 1.3        |
| 1.25%              | Advertising & Promotions       | \$78,000    | .9         |
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| 0.29%              | Card Issuing                   | \$18,000    | .2         |
| 0.24%              | Credit Authorization           | \$15,000    | .2         |
| 0.19%              | Enrollment                     | \$12,000    | .1         |
| 30.55%             | Total                          | \$1,915,000 | 21.4       |

### NET

| % of Out-standings | Source                         | Amount      | % of Total |
|--------------------|--------------------------------|-------------|------------|
| 5.37%              | Nr. Balance Trans              | \$335,000   | 3.7        |
| 1.83%              | Other Fees/ Penalties          | \$115,000   | 1.3        |
| 1.25%              | Advertising & Promotions       | \$78,000    | .9         |
| 1.24%              | Credit Reprints & Processing   | \$77,000    | .8         |
| 1.31%              | Statement Billings             | \$82,000    | .9         |
| 0.67%              | Cardholder Services            | \$42,000    | .5         |
| 0.55%              | Collection & Overlimit Control | \$34,000    | .4         |
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| 0.24%              | Credit Authorization           | \$15,000    | .2         |
| 0.19%              | Enrollment                     | \$12,000    | .1         |
| 30.55%             | Total                          | \$1,915,000 | 21.4       |

### TOTAL CARDS

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### EXPENSE

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### INCOME

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### NET

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### EXPENSE

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### INCOME

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

### NET

| Total Assets | Total Liabilities | Total Equity |
|--------------|-------------------|--------------|
| \$1,444,000  | \$1,000,000       | \$444,000    |

**Bank-card income, Expense and Profit.** Merchant discounts generate 18.7% of revenues (including interchange fees). Actual fees paid by convenience users contribute 3.6%. Finance charges, annual fees and other fees paid by revolving-credit users make up the remaining 71.7% of total income.

Fixed overhead for bank cards is 42.10% of total revenues. Losses from credit and fraud contribute 12.94%. The remaining 44.96% represents the

After-tax profits since 1978 averaged 1.30% of outstandings as follows... 1.96% for 1978, 1.30% for 1979... 1990 and 1981 showed losses of 1.25% and 0.87%... 1.73% for 1982, 1.99% for 1983, 2.24% for 1984 and 3.29% for 1985

**Usury laws are anti-consumer.** Any cap on bank-card interest would hurt the very consumers legislators claim to be protecting. In states where bank-card rates are already regulated, card issuers have managed to hold on to profits by tightening credit-granting policies, limiting cardholder services and restricting their marketing area. Bank-card operators that wanted to expand and improve customer services have already moved or are planning to move to one of the unregulated states.

When lower rates are mandated card issuers resort to other ways of generating income, one or more of which would be pursued if there were a ceiling on rates nationwide. Grace periods could be shortened or eliminated by charging interest from

HOW TO KEEP BANK CARDS AWAY FROM U.S. CONSUMERS

| STEP    | GOVERNMENT ACTION             | BANK-CARD RESPONSE                                 | CREDIT-CARD CUSTOMERS    |
|---------|-------------------------------|----------------------------------------------------|--------------------------|
| Present | None                          | Rates Reduced on 7% of Total Card Base             | 71,000,000 to 80,000,000 |
| I       | Tie Interest to Cost of Money | Raise Annual Fees and Curtail Credit               | 60,000,000               |
| II      | Fix Ceiling on Fees           | Eliminate Grace Periods and Add Transaction Fees   | 50,000,000               |
| III     | Mandate Grace Periods         | Raise Transaction Fees. Bill from Date of Purchase | 35,000,000               |

date of invoice, or date of posting, or date of purchase. New transaction fees and penalties could be imposed and present ones increased, including a fee just to process an application. Every opportunity to maintain reasonable profits would be explored in addition to raising qualifications and limiting acceptance to depositors and local residents.

Any drop in credit-card interest rates will be welcomed as long as it occurs in a free market where pricing is determined by consumer demand—not by government edict. Lower rates could benefit all bank-card customers whether they borrow

or not, but an arbitrary cap on rates would force banks to eliminate customers whose only loan alternatives are often at much higher rates.

Tying bank-card interest to fluctuating money rates has proven unpopular with cardholders in states where this practice already exists. Floating rates are confusing to customers who are never quite sure what they owe. They are also more costly for credit grantors to administer. Many customers in these states would be unable to get any bank card at all if they weren't rescued by one of the major nationwide card issuers such as Citibank, Bank of America, Chemical, Manufacturers and others that promote out-of-state. The fact that Citibank, which charges one of the higher rates in the nation, is also one of the nation's most popular cards with one out of every 17 bank cardholders in the country carrying one, indicates that consumers want a better product even if it costs a little more and are interested in shopping for interest a few points lower.

PRICING  
OPTIONS  
PER CARD





**Market Saturation.** If allowed to grow in a free-market environment, credit cards issued by banks will increase to 180 million by 1990 when they will be serving 77 million people. True saturation will not be reached until the customer base reaches 82 million and about 200 million cards are in circulation. But rewards from mass mailing preapproved applications to easy picks have just about dried up and future growth will be much more costly -- coming from tie-ins with affinity groups, special programs for students and promotions tailored to women and other market segments not heavily pursued in the past. Sears will give bank cards the biggest boost by spending hundreds of millions of dollars to promote Discover Card to lower-income groups who will eventually become bank-card customers.

Travel and entertainment cards led by American Express will increase from the present 18.5 million to 26 million in the next five years and then level off. All the other credit cards which are proprietary have reached market saturation. Retail cards totaling 341 million dropped 15 million last year. Oil-company cards at 117 million increased slightly but any future growth will have to come from travel cards that charge annual fees such as those available from Amoco, Shell and Sunoco with another from Texaco expected soon. Telephone cards issued primarily by AT&T have increased slightly to 75 million but future growth will be slow.

**PROPOSED NATIONAL BANK-CARD REGULATIONS.** January 1985 Rep. Henry Gonzalez (D-Tex.) introduced HR 591 to set a 10% usury rate on any consumer loan over \$300. February 1985 Rep. Mario Biaggi (D-N. Y.) introduced HR 1167 to establish a cap on credit-card interest at five percentage points above the Federal Reserve's discount rate. August 1985 Sen. Paula Hawkins (R-Fla.) introduced S 1603 to impose a cap not more than 5% above the average investment yield of 26-week Treasury bills outstanding during the most recent 12-month period preceding January 1st. September 1985 Rep. Charles Schumer (D-N. Y.) introduced HR 3408 to cap rates at six percentage points above three-month Treasury bills and mandate a study of the industry by the Federal Reserve. December 1985 Sen. Alfonse D'Amato (R-N. Y.) introduced S 1922 to limit credit-card rates to 4% over the IRS rate on late payments. This bill would also require that card issuers disclose rates and fees on applications and report them monthly to the Federal Reserve Board.

**POLITICS AND BANK CARDS (Continued from page 1)**... consumers using bank cards for revolving credit, all but a few would have a tough time getting the recommended cards because most low-rate issuers are small institutions that operate on relatively slim profit margins by restricting credit to local residents or depositors.

Politicians don't know enough about the bank-card industry to realize low-rate issuers can stay alive only by screening out all but the 10% to 15% of applicants that appear to be the best credit risks, and that this tends to eliminate most of the bank-card users that are price-conscious enough to shop around for lower rates. Most low-rate banks aren't set up, nor did they ever intend to handle any large volume of business. Some go out of their way to discourage new customers and many are ill-equipped to cope with the avalanche of applications they are getting thanks to lawmakers' misguided recommendations. To properly service the broad base of consumers handled by Citicorp, Bank of America, Manufacturers, First Atlanta, and other nationwide operations, banks have to charge the higher rates these legislators want to outlaw.

April 30, 1986

  
H. Spencer Nilson

THE NILSON REPORT  
NUMBER 379 APRIL 1986

## Credit Card War Erupts in Connecticut

Institutions Slash Rates in Battle with Money Center Invaders for Market Share

By MICHAEL WEINSTEIN

NEW YORK — A credit card war has erupted in Connecticut as three banks within a week have slashed interest rates to barely profitable levels.

The latest salvo was fired by Connecticut National Bank in Hartford, which is temporarily lowering its credit card rate from 18% to 11.75%.

"There's a rate war here like you wouldn't believe," said Brent DiGiorio, public relations officer at Connecticut National. In recent weeks, Connecticut Bank and Trust Co., People's Bank, and Society for Savings have also cut their credit card rates.

Meanwhile, Gov. William A. O'Neill is expected to sign into law today a bill that would lower the maximum allowable credit card rate in Connecticut from 18% to 15%.

"We're definitely going after the money center banks that have flooded the market over the last several years in Connecticut," said Donald Grigley, senior vice president at Connecticut National. He estimates that out-of-state banks, mainly New York City behemoths, control some 25% of Connecticut's credit card market.

Connecticut National's rate cut applies to purchases made between June 1 and December 31. Also, the bank will not charge new cardholders its customary annual fee — \$25 for regular cards and \$40 for premium cards — until the first quarter of next year.

"We don't see what's going on in Connecticut as a competitive threat," said Ken Herz, a vice president at Chemical Bank, one of the nation's biggest issuers of bank credit cards. He questioned the impact of a temporary rate cut.

Connecticut National has some 230,000 credit card accounts in Connecticut, making it the second-biggest in-state issuer behind Connecticut Bank and Trust of Hartford, which has about 370,000 accounts.

Connecticut National's new rate undercuts CBT, which last week lowered its card rate from 18% to 12% until Sept. 30 in an effort to expand its market share in the state.

"It's a high-use period," said Mark J. Formica, executive vice president at CBT. "Most people are vacationing in the states this year, and they're using their cards for vacation expenses, back-to-school expenses, and so on."

Since the program was announced on May 27, the bank has had 40 cus-

tomers service representatives manning toll-free telephone lines to accept credit card applications.

People's Bank in Bridgeport also undercut CBT when it announced earlier this week that it is lowering its credit card rate from 15.9% to 11.5% effective June 16 through September 30. This is the second rate cut in a matter of months for People's, which lowered its card rate from 17% to 15.9% in March.

And Society for Savings in Hartford, which lowered its card rate a few weeks ago, plans to cut its rate again, said Peter K. Mulligan, senior vice president at Society. Society's credit cards now carry a rate of 13.9%.

Connecticut bankers said they believe they can still turn a small profit on credit cards by charging 11% or 12%.

"Under this structure, I would be quite surprised if anything more than a very marginal profit would result," observed Donald J. Auriemma, a consultant based in Garden City, N.Y.

"Anytime you have a money sale, you'll have a lot lower return on assets," conceded Mr. Grigley of Connecticut National. "We're hoping that between an increase in volume and systems enhancement that it will cover at least the shortfall."

But, warned Mr. Auriemma, "You certainly would not want to begin an expansion program, because it leaves absolutely no room for rising bad debt." Credit losses are expected to rise as banks expand their credit card portfolios.

The Connecticut price war is the most concentrated example of the scattered rate-cutting by small and medium-size card issuers in recent months. Interest rates at most of the the top credit card banks, however, have not budged.

The battling financial institutions in Connecticut have cut their rates below what is to be the state's new legal maximum of 15%, even though the Connecticut Bankers Association is against the law. The banks and the Connecticut Retail Merchants Association, whose members also issue credit cards, have opposed the law, claiming that it would not achieve any real savings for consumers.

"The bill's going to become law and we're going to have to live with that," said Preston C. "Bud" King, executive vice president of the Connecticut Bankers Association. "But I don't know what the outcome will be." ■

Answers To Questions for Mr. Feldman  
Submitted from Senator Gorton  
Hearing: May 21, 1986

Q.1. Some of your member's cards, such J.C. Penney's, can be used at merchants other than the parent company. For conditions of competitive equity, shouldn't such credit cards be treated in the same way as bank cards?

Answer 1. A merchant's proprietary credit card cannot be used to make purchases from other merchants who are unrelated to the card issuer. This is true of J.C. Penney's credit card as well as those of all other merchants of which I am aware. This is also the case, in the vast majority of cases, when different merchants are owned by the same corporation (e.g., Allied Stores Corporation, Federated Department Stores, Associated Dry Goods, The May Department Stores Company, etc.). For example, when a consumer opens an account at a store owned by Federated (e.g., Bloomingdale's), that card represents the consumer's account at Bloomingdale's stores only. Presentation of the Bloomingdale's Credit Card at a different store owned by Federated may facilitate opening a new account at that different store (e.g., I. Magnin), but, with rare exceptions, it cannot be used to charge purchases at that different store. For this reason, among several others, the merchant's credit cards are clearly distinguishable from bank cards.

Q.2. You state that at least one state prohibits the average daily balance calculation method. Which state? What method does that state require?

Answer 2. Montana's statute does not authorize the average daily balance method. That state requires use of the ending balance as of the last day of the billing cycle minus the amount of purchases charged to the account during that cycle (Sec. 31-1-241(2) Mont. Code Ann.).

AMERICAN RETAIL FEDERATION

1616 H STREET, N.W. WASHINGTON, D. C. 20006 (202) 783-7971

JOSEPH P. O'NEILL  
PRESIDENT

STATEMENT OF THE  
AMERICAN RETAIL FEDERATION  
FOR THE RECORD  
IN HEARINGS BEFORE THE  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE

ON

S. 2421, S. 2264, and S. 2140

TO REQUIRE DISCLOSURE OF CERTAIN INFORMATION  
ON INITIAL CREDIT CARD APPLICATIONS

May 21, 1986

Washington, D. C.

Kelly McNamara  
Staff Assistant  
Corporate Governmental Affairs  
Sears, Roebuck and Co.  
633 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004  
202/737-4900

The American Retail Federation (ARF) is taking this opportunity to present for the record its views, comments, and observations regarding S. 2140, S. 2264, and S. 2421. ARF is grateful to the Subcommittee and its staff for the opportunity to make known its views on these legislative proposals.

Membership in ARF consists of 27 national retail trade associations, 50 state retail associations, the Greater Washington Board of Trade, as well as corporate members. Through its members, ARF represents more than one million retail establishments.

The majority of retailers represented through the Federation offer or extend consumer credit, most of which is in the form of open end (i.e., revolving) credit. The vast majority of those retail open end credit plans involve the issuance and use of credit cards. For that reason, ARF is vitally interested in the three bills to which this statement is addressed and the impact that those bills would have on retail credit card issuers.

The American Retail Federation is opposed to all three bills for a number of reasons.



Scope. Although they differ in certain particulars, the principal aim of all three bills is to require disclosure of specific information on or with the application or solicitation for a credit card account. S. 2140 and S. 2264 would apply to initial credit card account applications, and S. 2421 would apply to credit card "solicitation or advertisements mailed to the consumer." S. 2421 also would require use of the average daily balance method of computing the balance on which the finance charge is imposed (or an alternative that results in a lower finance charge) for any open end credit plan that involves a credit card under which credit may be extended by a party other than the provider of goods and services -- in other words, it would require use of the average daily balance method for all three-party cards.

For reasons stated hereinbelow, we believe that the disclosure provisions of S. 2140 and S. 2264 are unnecessarily redundant; consumers already are given the disclosures that would be required by those two bills before first use of a credit card account. S. 2421, on the other hand, is overly broad as well as redundant. It would mandate the prescribed disclosures in any advertisement of the availability of credit card accounts mailed to consumers.

Reading that requirement together with the broad definition of the term "advertisement" in Regulation Z (12 CFR § 226.2(a)(2)), the disclosure requirements of S. 2421 would apply to any "commercial message in any medium" that is mailed to the consumer and that "promotes directly or indirectly, a credit transaction." This would include, for example, flyers that are mass-mailed by retailers to consumers in advance of special sales if the material included even so much as an announcement that could be construed as promoting the availability and/or use of credit card accounts. Moreover, S. 2421 would require disclosures even if the advertising material were mailed principally to existing customers, because S. 2421 does not exclude credit card advertisements mailed to consumers who already have credit card accounts.

Thus, ARP feels that S. 2421 is (like S. 2140 and S. 2264) not only redundant but also unnecessarily inclusive.

Disclosure Provisions. Each and every item of information that would be required by these three bills to be disclosed to consumers at the time of application or solicitation/advertisement already is required to be disclosed either by the Truth in Lending Act (15 U.S.C. § 1637(a)) or Regulation Z (12 CFR § 226.6(a)) before the first transaction under an open end credit plan. Furthermore, if after receiving the disclosure

a consumer decides for any reason that he or she does not want to participate in the credit plan and withdraws from it, any membership fee paid before receipt of the disclosure statement must be refunded (Official Staff Commentary to Regulation Z, comment 5(b)(1)-1, 47 Fed. Reg. 41338, et seq.).

Thus, a consumer is not at risk for any amount, even a small membership fee, if, upon receipt of the full disclosure statement required by the act and regulation, the consumer does not care to participate in the credit card plan. Although retailers do not (and under some state laws cannot) assess an annual or a membership fee, consumers already are protected where creditors do impose such a charge.

One of our basic objections to all three bills, therefore, is that they require disclosure of items of information that credit card issuers are now required to furnish as a part of the disclosures given to the consumer before first use of the account. The disclosures required by all three bills simply are excerpted from the full disclosure statement that card issuers will continue to furnish after approval of an application but before first use of an account. ARF considers such requirements to be extravagantly unnecessary.

If, in fact, consumers now are being injured by reason of their failure to read the disclosures currently being given to them, furnishing the same disclosures twice within a relatively short period of time is not likely to improve their inclination to read those disclosures or their efforts to understand them. It is inequitable in the extreme to require credit card issuers to foot the bill for those disclosures, particularly when there is no evidence that the disclosure redundancy would really operate to protect consumers.

Average Daily Balance Computation. It appears that the provision mandating use of the average daily balance (or any alternative that produces a lower finance charge) in S. 2421 was intended to exclude retailers. It applies only to "any open end credit plan involving a credit card under which credit may be extended by a party other than the provider of goods or services." It must be remembered, however, that many retailers lease departments to third-party suppliers of goods and/or services under arrangements in which the actual provider does not extend credit. For example, many retailers have franchised or leased departments within their stores that sell merchandise (e.g., shoes) or services (e.g., optometric examinations) that may be charged to the consumer's retail credit card account.

In other cases, retailers might permit their cards to be honored by off-premises third-party providers of certain goods or services. For example, a retailer might have an arrangement under which its credit card may be used to rent a bicycle from a third-party provider or pay for plumbing services furnished by a local plumbing shop. In any of the foregoing cases, all accounts under the entire credit plan would be subject to the average daily balance requirement, because the provider of goods or services "may" be a party other than the extender of credit.

In any event, however, ARF is opposed to any proposal to mandate use of the average daily balance method to compute finance charges. The use of this method requires a degree of sophistication in both hardware and software that is not readily available to many retailers. For example, the researchers from the Tayloe Murphy Institute of the Colgate Darden Graduate School of Business Administration at the University of Virginia made public their findings about balance assessment methods in use, as follows:

"A variety of balance computation methods are in use by Virginia retailers. Less than a third of the retailers reported using average daily balances to compute finance charges; rather, they are relying on methods that can be readily computed manually." Report of the Tayloe Murphy Institute, The Colgate Darden Graduate School of Business Administration, University of Virginia, Credit Card Billing Practices in Virginia, Senate Document No. 4 (1986), p. 5.

Many retailers, particularly smaller retailers, continue to use mechanical billing equipment that simply will not compute the average daily balance for purposes of assessing finance charges. Many other retailers that have access to computers are relying upon off-the-shelf software that does not compute average daily balances. Still other retailers have access to service bureaus with only limited (or no) ability to develop average daily balance programs.

ARF flatly rejects any premise that would lead to the conclusion that it is the function of Congress to impose on retailers -- particularly small retailers -- by legislative fiat the requirement that they (the retailers) compute finance charges using a basis as complex as the average daily balance, with taking "lower finance charges" as the only legal alternative. Thus, the American Retail Federation is adamantly opposed to S. 2421's proposed addition of section 127(d) to the Truth in Lending Act that would impose any such requirement. That requirement is confiscatory with respect to retailers, while it provides little or no benefit to consumers.

The average daily balance method of computing finance charges is not intrinsically more fair, nor, for that matter, does it necessarily produce a lower finance charge than does any other given method of computing finance charges. The purchasing



and paying habits of the consumer are far more important determinants of the finance charge -- and Congress surely will not try to dictate mandatory purchase and payment patterns to consumers.

In any event, requiring the use of the average daily balance method most assuredly is not an appropriate or proper undertaking of the federal government.

Civil Penalties. Essentially, account solicitation is advertising. Its purpose is to gain consumers' acceptance and use of credit card accounts, just as conventional product advertising is intended to gain consumers' acceptance of the merchandise or services offered for sale. To be effective and at the same time economically feasible, account solicitations must be conducted on a mass marketing basis. Because mass marketing techniques are used, one small mistake in disclosure (e.g., a typographical error) could be vastly magnified when placed in the mail boxes of scores of thousands of consumer recipients, thus exposing a card issuer to seemingly endless litigation.

It is true that violation of the disclosure requirements of the three bills here under consideration would not be subject to recovery of automatic civil penalties (twice the amount of the finance charge; \$100 minimum; \$1,000 maximum)

provided under 15 U.S.C. § 1640(a)(2). It is also true, however, that we are a litigious society (see, e.g., The Wall Street Journal, east. ed., June 3, 1986, p. 1). The fact that the disclosure requirements of these three bills would remain subject to suits for actual damages, plus attorney fees and court costs, very likely would make mass marketers high profile targets for that type of litigation.

In the original Truth in Lending Act, Congress recognized that advertising/solicitation is inherently different from disclosure. Disclosure requirements are set out in Chapter 2 of the Act (15 U.S.C., Part B, § 1631, et seq.), whereas the advertising provisions are in Chapter 3 (15 U.S.C., Part C, § 1661, et seq.). That format of chapters remains unchanged today, even after more than a score of amendments to the Act.

Congress also recognized that civil penalties were not appropriate for advertising infractions, because no credit actually had been expended at the time an advertisement appears, and the consumer is under no legal obligation to make any payments. Accordingly, the requirements of Chapter 3 of the Act -- Credit Advertising -- are not subject to civil penalties, even those for actual damages.

All three of the bills here under consideration would subject violations of the proposed new application and advertising/solicitation disclosures to claims for actual damages -- even though, at the time those disclosures are made, no credit had been extended and the consumer is under no legal or other obligation to make payments. Surely, such a provision would be a trap for the unwary creditor, and more important, it could be a windfall for consumers. Such a provision could be used as a tool with which to harass card issuers into a settlement rather than pursuing more expensive litigation -- even when no one had, in fact, been damaged by an informational error in a credit advertisement.

ARF is opposed to any statutory or regulatory scheme that imposes what could be very substantial exposure to civil penalties -- exposure that could be used to elicit settlements from card issuers as the only alternative to expensive litigation -- when no credit has, in fact, been extended.

Summary. For all of the foregoing reasons, the American Retail Federation urges the Subcommittee to reject S. 2421, S. 2264 and S. 2140 in their entirety.

ARF is grateful for the opportunity to present its views. If the Subcommittee or its staff should have any questions about the foregoing statement, ARF will be delighted to respond to those further inquiries.

AMERICANS SAY BANKS COULD DISCLOSE FAR MORE ABOUT CREDIT CARDS  
Absence of Guidelines Causes Confusion

Testimony Submitted  
to the  
Subcommittee on Financial Institutions and Consumer Affairs  
Senate Committee on Banking, Housing and Urban Affairs  
Senator Slade Gorton, Chairman

by  
John Crothers Pollock, Ph.D.  
Editor-in-Chief and Publisher  
Bank Credit Card OBSERVER  
120 Wood Avenue South  
Iselin, N. J. 08830

May 21, 1986

## AMERICANS SAY BANKS COULD DISCLOSE FAR MORE ABOUT CREDIT CARDS

Absence of Guidelines Yields Confusing Mix of Options

Six out of ten Americans (61%) believe that banks could reveal a great deal more about financial obligations of bank credit card use when they send potential customers credit card applications. Only about three out of ten (28%) say that banks send customers essentially all the information they need to know about bank credit card interest rates and fees along with credit card applications. (The remaining 12% "do not know.")

These are some of the results of a national random survey conducted in early May by the Bank Credit Card OBSERVER, a monthly newsletter surveying bank credit card offerings throughout the United States, as well as public opinion regarding bank credit card use. This survey and an independent analysis of over 50 bank credit card applications from many regions of the country confirm two observations:

1) Although a majority of Americans are largely unaware of substantial variations in credit card interest rates throughout the country, five out of ten wish to learn more, and six out of ten believe banks could reveal far more than they currently do about financial obligations.

2) Due to wide variation in disclosure patterns from bank to bank, consumers are compelled to cast a wide net of inquiry to learn the facts about bank credit card use.

A detailed look at the results of original opinion research and independent examination of many bank credit card applications illustrates the significance of these two findings.

### Two Assumptions Challenged

Finding that Americans are convinced banks could reveal a great deal more about the financial obligations of bank credit card use casts serious doubt on two assertions made frequently about card use, specifically:

- Assumption #1: "Americans are aware of their choices and the financial obligations of those choices, but are apathetic and choose not to shop around."

- Assumption #2: "One-third to one-half of bank card holders don't even care about annual percentage rates because they pay off the entire balance each month anyway."

Regarding the first assumption about consumer awareness, the May, 1986, issue of the Bank Credit Card OBSERVER contains a national survey revealing that the majority (61%) of adult Americans are unaware of the wide variations in annual percentage rates for bank credit cards; and about half (49%) wish to learn more about low rate cards. (An additional 12% are undecided or don't know.) Coupled with the June issue's finding that a majority of American adults believe banks could do a great deal more to reveal a great deal more about the financial obligations of bank credit card use, it is clear that a public opinion mandate exists to urge or persuade banks to reveal much more about the terms of banks credit card use.



Regarding the second assumption about so many card holders paying off the monthly balance in full "anyway," that practice may, in fact, reflect an attempt by a number of American consumers to avoid the high credit card interest rates that they believe are charged by many banks, a belief that may be reinforced by a widespread pattern of insufficient disclosure of the complete facts about rates and fees charged for bank credit cards across the country.

Full disclosure is desirable not just because public opinion approves it, but also because current practice produces such a wide variation in terms, not just among regions, but within cities and among banks, that customer confusion is almost inevitable. This condition is illustrated in an examination of credit card applications from many banks in the United States.

Consumers Compelled to Cast Wide Net of Inquiry for Facts about Bank Credit Cards; Wide Variation in Disclosure Terms from Bank to Bank

Banks differ greatly in the amount and clarity of information sent to customers along with bank credit card applications. Consumers are therefore compelled to cast a wide net of inquiry if they are to make informed choices about the best bank credit card terms for their individual needs.

After analyzing bank credit card applications from over fifty banks in different regions of the United States, the Bank Credit Card OBSERVER finds that no single city or state can

be judged as "superior" to another in the quality and quantity of consumer information sent with mail solicitations. A detailed comparison of ratings for each bank will be reported in the future, but several impressions are immediately clear.

These disclosure judgements are based on whether or not banks provide information on the following conditions:

- o Annual Fee
- o Annual Percentage Rate (A.P.R. or interest rate)
- o Method of Computing the A.P.R.
- o Grace period
- o Transaction fees
- o Cash advance information, such as:
  - Annual Percentage Rate (if different from that applied to transactions)
  - Grace period for cash advances (if different)
  - Transaction fee for cash advances

Annual Fees Often Mentioned in Applications; Interest Rates Listed by Only About Half the Banks; Little About Cash Advances

Annual fees are listed often in bank credit card applications, but over one in four banks in the over fifty applications collected thus far does not mention an annual fee. Only about half the banks mentioned annual percentage rates, a curious circumstance in institutions asking target customers to trust them sufficiently to maintain an interest-bearing balance. Fewer banks mention how the interest is computed, and few note

anything about the terms of their grace periods (whether computed from date of billing, date of posting, or date of transaction). Almost no institutions at all say anything about cash advances and their terms.

For a good many customers who take advantage of bank credit cards, the first time they encounter the full terms of their obligations and responsibilities is when they receive the first bill, which may already contain an annual fee and other charges not previously mentioned. It is curious that customers are expected to be obligated to terms for which there is no previous explicit agreement. It may be even more surprising that so many bank card customers appear to agree to numerous financial obligations without understanding or even learning about them completely.

The bank credit card applications in the sample of over fifty banks can often be placed in one of three categories:

- o High Disclosure: Application contains a detailed explanation of conditions, rates and fees associated with bank credit card use.
- o Medium Disclosure: Application contains some explanation of the conditions, rates and fees associated with bank credit card use.
- o Low Disclosure: Application contains little or no disclosure of the terms of bank credit card use.

Wide Variation Within Cities; Language Often Obscure

There is, often a great deal of variation in disclosure levels from bank to bank within the same city. There appear to be few consistent guidelines regarding disclosure, since little consistency is found either within states or cities.

Even when "high disclosure" is found in a bank credit card application, the language used to convey information is often obscure and legalistic, difficult to decipher. A major exception to that impression is Central Carolina Bank of Durham, which states its terms and bank credit card holder rights in a clear, easily accessible format.

Most banks do seem to write clearly, however, when they wish to inform potential applicants about the multiple benefits of bank credit card use, for example: insurance options, lines of credit, car rental discounts, overdraft protection, and other conveniences. Yet in discussing the terms and obligations of card use, far less attention is paid to clarity and ease in information access.

"High Disclosure" Banks Found at both High and Low Interest Levels

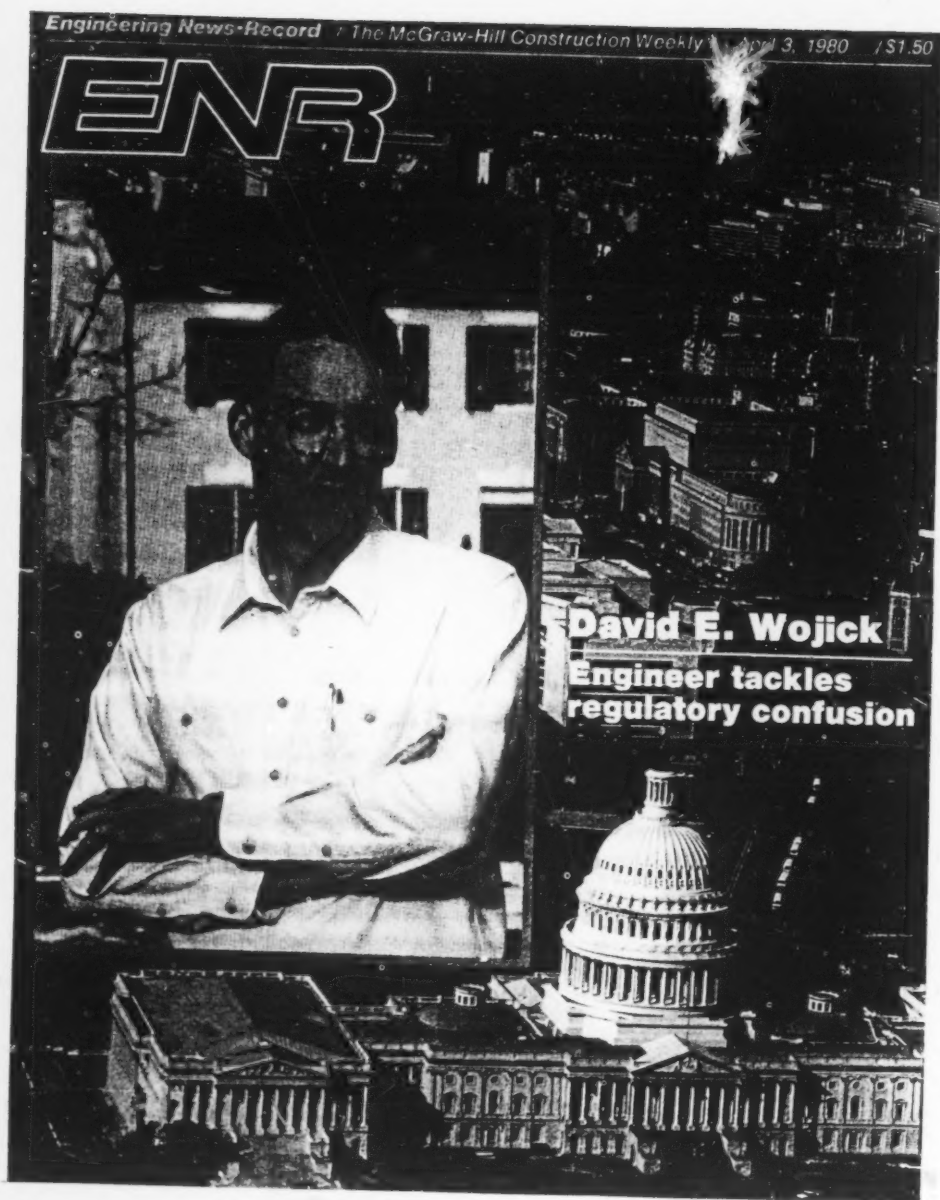
Banks revealing a great deal about customer rights and obligations can be found offering either low or high interest level cards. Several banks with low bank credit card interest rates disclose a great deal, for example: Simmons Bank and Union National Bank, both offering 11.5% annual percentage rates in

Arkansas. Yet two banks with high (19.8%) bank credit card interest rates, First National Bank of Chicago and Bank of America, also reveal a great deal about the terms of their credit cards, including specific information on cash advances seldom mentioned in the applications offered by most other banks.

#### The Need for Consistent Guidelines

In trying to find out the facts about different bank credit card options, most consumers are clearly at a disadvantage. With so much variation -- in annual fees, annual percentage rates, grace periods and their specific fees -- across the country from bank to bank, and even within cities, the intelligent consumer, unless he has access to a special data base, is compelled to spend a great deal of time and money on comparative shopping.

Since so few applications are similar in the kind and clarity of information offered, an average consumer is still faced with the arduous task of finding ways to compare different terms, different languages, and different levels of disclosure. It is not surprising that many consumers in America remain unaware of the many choices available to them in selecting bank credit cards. A clear set of uniform guidelines for disclosing bank credit card terms would help everyone.



61-654 208





Paul N. Roth, Jr. is Vice President of Banconsumer Service, Inc. in Tonawanda, New York. Banconsumer produces retail bank forms for all types of financial institutions and serves as a consultant on compliance-related topics. With the inception of New York State's plain language law in 1978, Banconsumer has been preparing plain language forms for hundreds of clients. Mr. Roth is a graduate of Canisius College and works in the area of new product development.

Dr. David E. Wojick & Diane W. Adams comprise an award-winning husband and wife team, working with Banconsumer for 5 years to develop plain language and compliance services and products. They have combined their training in logic, engineering, English, and management to pioneer new methods like the issue tree, created at Carnegie-Mellon University in 1973. As analysts and reformers, they work with many firms, associations, and agencies, including the American Bankers Association and the Executive Office of the U.S. President. Through Banconsumer, they offer plain English conversion, testing and certification, compliance planning, and regulatory criticism.

WINTER 1984

## PLAIN LANGUAGE

*Sometimes  
it's not all that  
simple*



by Paul N. Roth, Jr., David E. Wojick, and Diane W. Adams

**C**aveat emptor or "let the buyer beware" has long been a popular truism, especially applicable when a consumer signs a contract filled with legal language and obfuscated by fine print. But as more states enact plain language laws, the truism may have to be modified to "let the banker beware."

This is because conversion of your bank's consumer documents will not be easy, nor will it necessarily produce briefer forms. It is, however, a useful exercise, not only for the customers (who will be better informed about their obligations) but also for banks (which will find that their overall compliance with disclosure requirements will probably improve). As an unexpected benefit, many banks have found that plain language forms can be featured in advertisements, which makes them an effective marketing tool as well.

First, let us define what is meant by plain language conversion. Generally, there are two schools of thought—the simple-minded and the fully informed. Using the simple-minded approach, you simplify by making things shorter, without giving thought to legality. Simplifying the language does not

simplify the law, however; it merely hides it from the consumer.

The fully informed approach, on the other hand, recognizes the right of the consumer to understand the contract. Clear, complete disclosure makes compliance easier too. This is what plain language laws are all about.

### Background

Essentially in a class with consumer protection laws, language regulation has a long history. Contracts have traditionally all contained similar information, and attorneys knew what information had to be included to make contracts legal and binding. As new laws were enacted, contracts were rewritten to reflect the changes. But they were still written in a strict, legal fashion, as they had been for years.

With the Truth-in-Lending Act (TILA) of 1969, the content of consumer credit contracts became closely regulated. No longer was the layout and design a result of the author's wishes. Banks were now dealing with a law that had many technical guidelines to be observed.

Certain words and phrases, such as annual percentage rate and finance charge, became part of our



vocabulary. These, and other key terms, had to be printed in a way that would make them more prominent than the rest of the language in the contract. Certain information was now required on the face of the contract. We began to define terms; for example, the components of the finance charge had to be itemized.

Suddenly we found ourselves on the road to language regulation, with other laws besides TIL being enacted. For example, RESPA led to standardized mortgage forms and disclosures. Regulations B and E also specified forms and types of disclosures for consumer transactions.

Many lenders did not wait for regulation to make the change. Citibank began using unsecured notes in plain language in the early 1970s (and used it as an effective marketing tool as well). New York State led the way with a law in 1978, and many other states soon followed. In the Truth-in-Lending Simplification and Reform Act of 1982, the federal government encouraged the use of plain language by incorporating simple concise phrases in its model disclosures.

The enactment of a plain language law in your state, when it happens, means the beginning of an enormous project for compliance officers. Total involvement from the beginning is a must.

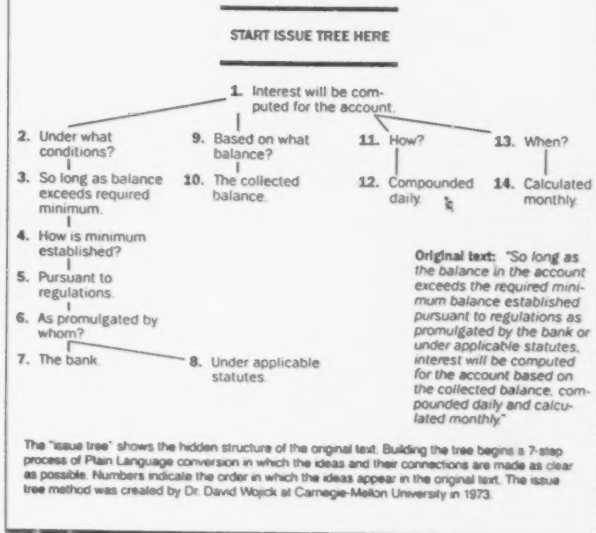
In this article, we will present one method of dealing with bank conversion to plain language. The use of issue trees, developed by Adams and Wojcik and proven to be effective in accurately identifying all points that must be disclosed, will be explained. By employing this method, you can see what should be disclosed, and perhaps more importantly, what is missing. It will probably take more words to describe the duties of both parties when writing in plain language, so an issue tree or similar device will provide you with a logical starting point for drafting clear, concise language.

By using the issue tree approach, you can determine the sequence for proper disclosure. This article will also present a seven-step approach to working with issue trees. Figures 1 and 2, which show the first and last steps in working with an issue tree to rewrite the



FIGURE 1

STEP 1: "Tree Out" the Text



original text of a money market deposit account agreement, will be referred to throughout the article.

### Preparatory Phase

Most plain language laws are far-reaching. Be aware of all areas of the bank that may be affected. Most of the laws banks are subject to govern consumer transactions, such as applying for credit, leasing property, contracting for services, or obtaining insurance coverage. Knowing the full scope of the laws will enable you to identify which forms should be changed. (It is easier to begin by changing only what is required by law; commercial transactions and some consumer transactions, if they are over a specified dollar amount,

are usually exempt.) As the bank's compliance officer, you should thoroughly analyze all of its consumer contracts. The compliance officers of banks affiliated in a multibank holding company should meet to review all of their forms collectively.

Conversion to plain language allows you to do some "house cleaning." As you review the bank's forms, you may find duplicate or obsolete forms. By standardizing and eliminating surplus forms, you gain control over your documentation.

Check with your marketing department on its plans for new products. You do not want to heavily advertise a new service, only to discover that the necessary forms do not comply with the law.

Above all, maintain a constant dialogue with your legal depart-

ment. The forms you are working with are legal documents and must adhere to the applicable laws. You will find that most of the provisions found in consumer contracts are not imposed by the bank, but rather by law. What constitutes default? How many days must pass before a late charge can be paid? Does the bank insure the contents of safe deposit boxes?

Even though a law may require clear disclosure to the customer, the bank should never forego any of its rights in a language simplification process. Since contracts were initially drafted by attorneys, their advice and guidance should be sought in these projects. Remember, forms are not just administrative or marketing tools for the bank; they represent binding obligations. As such, bank counsel may have to defend or initiate action based on the contents of these forms. Legal review is necessary, therefore, to ensure that bank rights are not lost in the translation.

### ***The Conversion Process***

Where and how to start this translation process is always a perplexing question. First, identify all of the forms that must be changed, and then work with one group at a time. Suppose you begin with the forms used in the deposit operations of your bank. As you review these forms, notice that some of the language is the same from document to document. If you attempt to make this language generic in nature, you will find that the wording is easily interchangeable among forms.

It is important to have someone who is very familiar with the documents to monitor the progress of your revisions. No matter who does your plain language drafting, a thorough review is paramount. An advertising or linguistics consultant may know design and grammar, yet may be unaware of the inner workings of your organization. As you translate each section, pass it along to your counsel for review. Have him or her identify the points that are necessary to preserve the rights of both the customers and the bank. As the forms undergo this step-by-step scrutiny by the drafting, legal,

and departmental staffs, they begin to take shape.

As already mentioned, by employing the issue tree method in your plain language conversion projects, you can see what is to be disclosed, and perhaps more importantly, what is missing. In the rest of this article, we will explain the seven steps in applying the issue tree concept to convert your bank's forms to plain language.

Taking these seven steps may seem like a lot of trouble, but you get a lot for your efforts. This process is more than just taking a red pencil and trying to rewrite. In particular, since more than one person is involved in conversion—legal, compliance, marketing, and policy people, for example—the extra effort of using issue trees and a step-by-step approach can save an enormous amount of group time. And the product will be better because the task was approached in an organized way.

### ***Step 1— "Tree Out" the Text***

Each idea in a text is directly connected to only a few of the other ideas. These connections occur because each idea answers an unspoken question asked of some other idea in the text. Diagramming these connections and filling in the questions makes an issue tree of the text.

The purpose of the issue tree is to reveal the hidden structure of the ideas. Often this hidden structure is responsible for the confusing aspects of the text. Also, the tree lets us distinguish what needs to be clarified. As a result, we can proceed step-by-step without losing any ideas in the conversion.

In the example (Figure 1), we see that there are 14 separate ideas presented in this section of text. Note that one-half of the ideas fall under item No. 2. This group pertains to the minimum balance. The rest of the ideas form a more or less natural grouping, having to do with the computation of interest.

The tree lets us talk about the ideas as things we can see and point to, with a definite structure we can conceptualize. This helps us redesign the text for maximum clarity,

coherence, and completeness. The issue tree helps us discuss the text with other bankers and attorneys the way a blueprint helps an architect discuss a new house with the owners.

### ***Step 2— Balance and Complete the Tree***

Now is the time to sit down and decide if you have, in fact, identified all the ideas. You can eliminate ideas to simplify the document. You can add ideas to increase protection or disclosure. You can also change ideas that are not quite correct.

For example, idea Nos. 4 through 8 explain how the minimum balance is established. Does the customer really need this information? If not, then we can cut the number of ideas by over one-third. This either shortens the document or makes room for more important ideas.

In terms of adding ideas, idea No. 10 is a prime candidate. We have found that few consumers understand the term collected balance.

You might propose that several points be added to explain what a collected balance is and how long it usually takes to collect on a check.

The process of adding and deleting ideas is carried out without worrying about how the ideas will ultimately be arranged in the document, what words will ultimately be used to express these ideas, how long the sentences will be, and so on. Each of these document design tasks comes later in the step-by-step conversion process.

### ***Step 3— Set Your Standards***

There are degrees of plain language, so you have to choose standards for readability, vocabulary, length of paragraphs, type size, and so on. In some states, many of these features are set in the plain language law, but usually it is up to the bank.

A useful standard for vocabulary is an elementary school level dictionary. Several companies publish them. You will probably be amazed to see how many words are supposedly able to be understood by 8th graders, so these books give you a lot to work with. Note that, where

it is felt that a technical term must be used, its plain language translation can be put in parentheses after it to help the reader.

Watch out for both legal and banking jargon. "Warrant and covenant" is a legal term that stands out, but how about "security interest," "collected balance," or, for that matter, "balance" itself? Lacking an industry standard, each bank must decide where to draw the line. It is better to set a standard for all your documents together, rather than piecemeal.

#### Step 4— Pick a Traverse

In other words, line up the ideas. The issue tree shows that the ideas in a document often go in more than one direction. There may be more than one question asked concerning an idea and more than one answer to a question. In fact, it is because the ideas often branch out in this way that we call the diagram an issue tree.

Written text does not branch out like an issue tree. Two sentences cannot be arranged without putting one before the other. Sentences go in single file, as do the words in them. As a result, there is no way to keep every idea in the tree precisely next to the idea it modifies when we convert the tree into written text.

If you study the example, you will see that there are many ways of lining up the ideas, depending on how you want readers to work their way through the tree structure. We call each way of lining up ideas a traverse of the tree. One traverse is indicated by the numbers assigned to the ideas in the example. These numbers show the traverse used in the original text. You might think another traverse is clearer, such as presenting idea Nos. 9 through 14 first, followed by Nos. 2 through 8 as a special condition. Likewise, you could decide that No. 14 (when interest is calculated) should be explained before No. 12 (how interest is compounded).

One reason that complex documents are hard to grasp is that ideas branch out visually in an issue tree but do not in written text. The next three steps are designed to help the

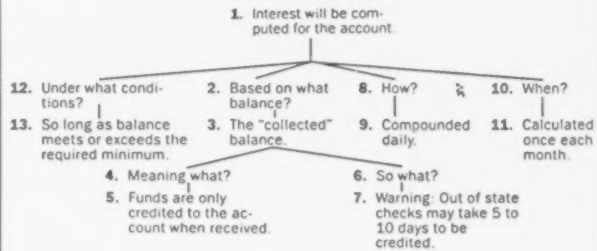
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FIGURE 2

#### STEP 7: Add Grammar and Print the Document "How and when interest is computed."

##### START ISSUE TREE HERE



##### Final Text: HOW AND WHEN INTEREST IS COMPUTED

**Balance must be collected** Interest will be computed for the account based on the "collected" balance. This means that funds are only credited to the account when received.

**WARNING:** Out of state checks may take 5 to 10 days to be credited.

**How and When** Your interest is compounded daily. We calculate your interest once each month.

**Minimum Balance Requirement** Interest will be computed for your account so long as the balance meets or exceeds the required minimum.

**NOTE:** Addition and deletion of ideas must be approved by legal, compliance, policy, and marketing personnel. Readability and vocabulary standards, warnings, etc., are those adopted by the bank or required by state law.

*This example is for illustration only. It is not intended as the authors' opinion as to how best to convert the original text.*

reader to see the tree through the traverse.

#### Step 5— Group Ideas

Sections, paragraphs, and sentences are all groups of ideas. These groups should be as natural as possible; that is, each unit of information should contain only those ideas that are closely connected. Often

this simply means pointing to the issue tree and saying "These ideas go in the first paragraph," or "These three ideas belong in the first sentence," and so on.

For discussion, you can delineate a proposed grouping by drawing lines around different groups, groups within groups, and so on, using different colors if necessary. Grouping, like picking a traverse, re-

BANK COMPLIANCE

quires intuition. You are trying to guess in what sequence the reader should encounter the information. This requires knowing what ideas fit together naturally.

In the example in Figure 1, idea Nos. 1 through 8 form a natural group, but one that is too large for a single sentence. Therefore, you should present them in a paragraph with two sentences. Idea Nos. 1 through 3 should be in first sentence, and idea Nos. 4 through 8 should be in the second. If idea No. 10 is amplified, as suggested earlier, it will constitute a grouping for another paragraph. Finally, idea Nos. 11 through 14 make a good paragraph and might even be put into a sentence together, if that fits the traverse you have chosen.

In making grouping decisions, you must decide which answers to questions should be made explicit to the reader. When two closely related questions are being answered in one sentence, confusion often results. In the example, the difference between *how* interest is compounded and *when* it is computed confuses many people. Using the simple words "how" and "when" helps. This word usage is what is meant by expressing ideas explicitly.

#### Step 6— Apply Structural Helps

Structural helps are items like headings for paragraphs, sections, and chapters. Other helps include numbering and lettering, cross-references, tables of contents—anything that helps reveal the hidden structure (the tree) of ideas to the reader.

For example, all the ideas in Figure 1 might fall under the heading, "How and When Interest Is Computed." The group comprising idea Nos. 2 through 8 could use a subheading like "Minimum Balance Requirement." Designing structural helps is an art requiring a good eye for themes and underlying concepts.

Structural helps aid people in finding answers to their questions, in scanning a document to get a sense of it, and in grasping the connections between ideas. It is easy to understand each sentence individually but still miss the point of a document if the connections are miss-

ing. For this reason, structural helps play a major role in plain language conversion.

Interestingly, the ultimate structural help is the tree diagram itself. We have found that very complex legal and regulatory concepts can be communicated quickly to bank personnel and customers using issue trees instead of ordinary documents.

#### Step 7— Add Grammar and Print the Document

Now we are ready to write complete sentences and finish our document (Figure 2). In this step, readability and vocabulary standards apply, along with type size and anything else that is necessary for finishing the text.

Other very important elements are the words and phrases you use to link sentences and ideas. We call them "referring expressions." A referring expression is anything in a sentence that refers to a topic or object already introduced. Pronouns like this, that, and which are all common referring expressions. Such expressions ("such expressions" is itself a referring expression) help reveal the connections between ideas demonstrated by the issue tree.

In contracts, the use of personal pronouns (I, you, we) requires a major decision by the bank. The use of pronouns is seen by many as the hallmark of plain language, but the question of who "I" is arises. The normal consumer contract is in the voice of the customer; that is, the customer is "I" and "we" and the bank is "you." But people find it strange to read a disclosure document in which "you" is not themselves.

Some banks have reversed the order and made "you" the customer and "we" the bank. If this is done, some language must be included in the document to indicate this shift in voice from the usual contract, otherwise, the result, taken literally, is meaningless.

Most state laws provide exemptions from compliance for contracts that use plain language promulgated by a government agency. This has helped greatly. Instead of being a stumbling block, model language can be used to its full advantage in



#### Language Simplification Checklist

- ✓ Do not use Latin or archaic words and phrases.
- ✓ Avoid double negatives and long unwieldy sentences and paragraphs.
- ✓ Stay away from words and phrases that, when used in a legal sense, may have a different meaning than the one generally accepted.
- ✓ Refrain from using exceptions to exceptions.
- ✓ Identify all parties by using personal pronouns. Clearly distinguish who the pronouns apply to at the beginning of the contract.
- ✓ Apply headings and subheadings or otherwise call attention to the major points of a contract, such as late payment, insurance, collateral, or billing errors.
- ✓ For your larger contracts, adopt newspaper-style columnar design. This allows the readers to quickly scan the page and find the area they are looking for.
- ✓ Check with your purchasing department to determine current inventories. You may not want to stock too many forms if a major regulatory change is forthcoming.
- ✓ Review long-range advertising plans with your marketing department. If you plan to introduce a new product or service, review the documentation to see whether it complies with the new law. The new "easy to understand" forms can be used as an effective marketing tool.
- ✓ Stay in close communication with your legal department. You do not want the bank to lose any rights or remedies because of faulty plain language.
- ✓ This may be a good time to change the layout and design of your contracts. Graphically attractive forms are easy to read when properly sectioned and captioned.
- ✓ Advise the operations department of all changes. A common result of language simplification is longer forms. Make sure that the bank's filing systems can accommodate oversize documents.



your bank's conversion process.

For example, mortgage lending requires extensive documentation. If a standard eight-page mortgage were converted to plain language, it might become a small book. However, by using the standard FNMA or FHLMC form, you do not have to devise your own plain language document. Most states with plain language laws have recognized these forms as standards of the industry, qualifying as evidence of compliance.

Model forms may not always suit your bank's needs. If their style is totally different from yours, it may be difficult to work these forms into your system. The Truth-in-Lending Simplification and Reform Act specified simple language in its model disclosures, which use the second person (you), both singular and plural, when explaining the borrowers' costs.

Other plain language writers use the first person to identify the borrower. They argue that the contract is more readily agreeable to a consumer if he reads "I," "mine," or "my."

When using a standardized or model form, either whole or in part, check the identity of all parties throughout the contract. These forms may be modified to fit your particular needs, but any changes should be made uniformly throughout the whole contract.

By clearly defining some basic parameters for your language conversion, you can better control the final product. Strive for uniformity. It not only aids in simplification, it makes the users feel more comfortable with the forms.

### Conclusion

As you can see, the plain language conversion process is an exacting one and not to be taken lightly. It involves the resources of many people from inside and outside your bank. The use of an issue tree is a good starting point. And, while the example discussed in this article will not solve all your problems, it can serve as a reference. Identification, clarity, coherence, and completeness are the keys to plain language conversion. Once

you have converted a form or document, use its terms and format as a standard—it will make the rest of the job easier. And don't neglect seeking advice from your legal counsel as you make changes.

In the end, the advantages will far outweigh the initial problems, as clear, complete disclosure makes compliance easier.

## ISSUE ANALYSIS

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*Engineering News Record*

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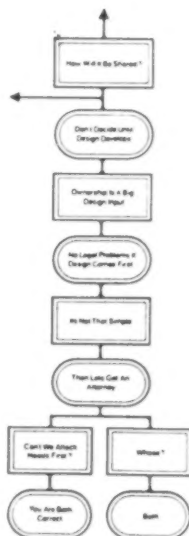
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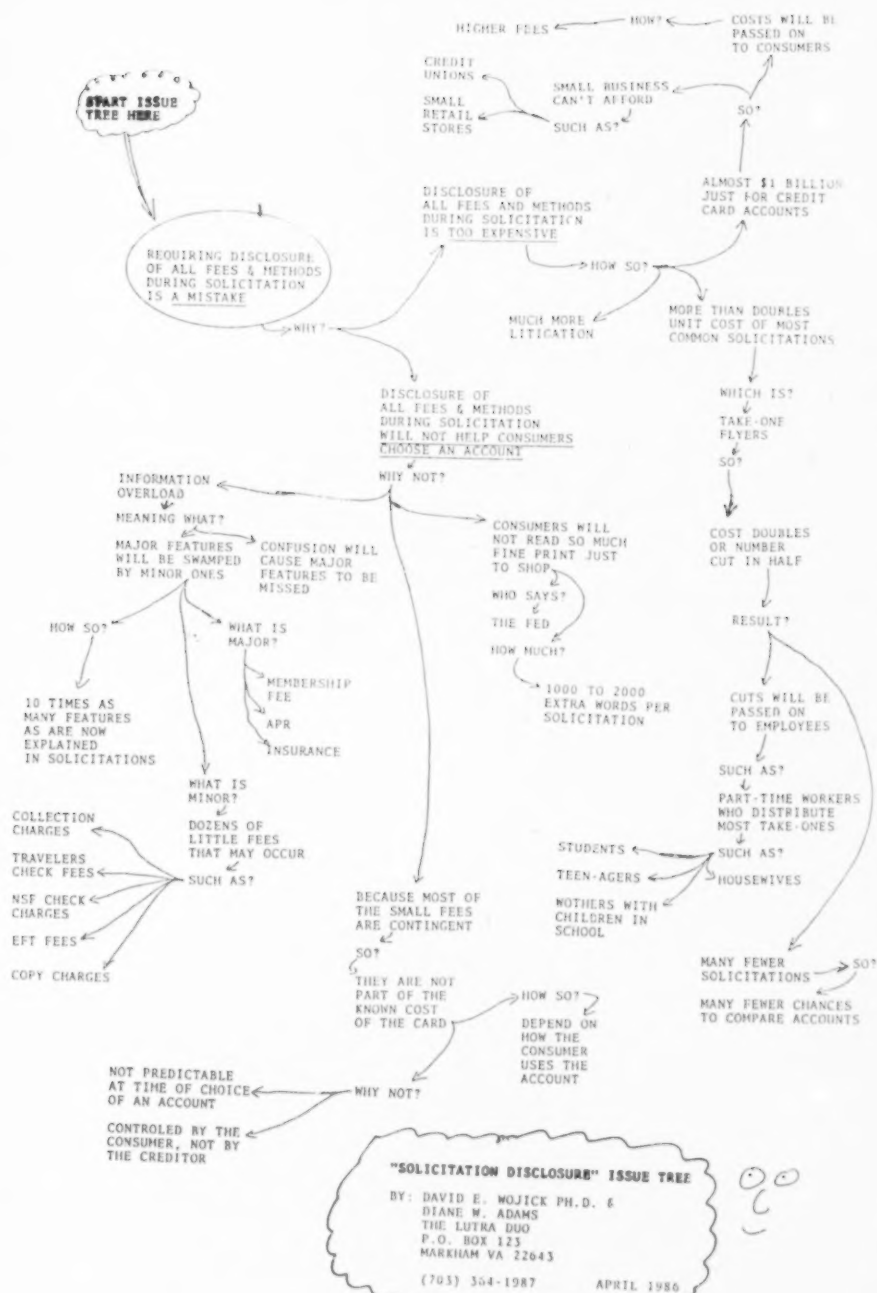
Issue analysis significantly reduces the amount of time and effort needed to master a complex issue. Issue diagrams can be used to communicate complex ideas accurately and quickly, avoiding costly misunderstandings.

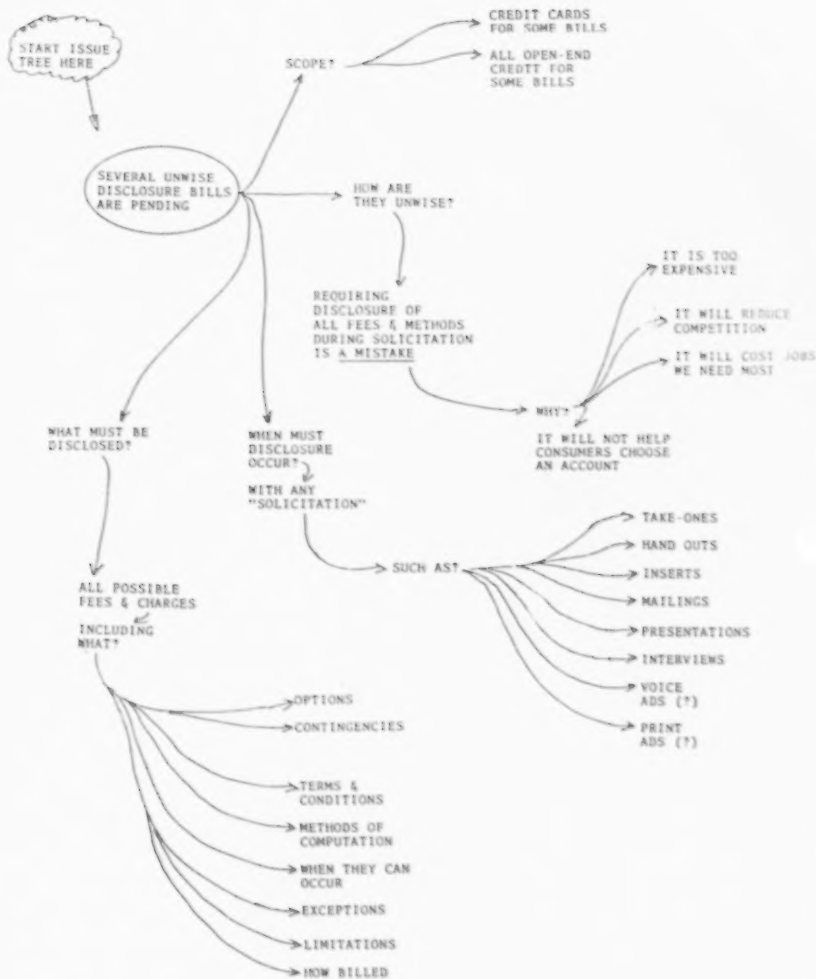
"I understand only one thing and that is confusion. Whoever understands confusion will find the heart of the battle." Wojcik

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"DISCLOSURE BILLS" ISSUE TREE

SUMMARY

Credit card disclosure bills are often well intentioned. Giving consumers more information to enable them to comparison-shop is a worthy objective. However, the amount of information required to be disclosed by these bills is simply too much, too soon in the credit granting process. \*

Specifically:

- Over 1,000 words of text will be required for each disclosure statement -- about 10 times as much information as is now provided.
- The "information overload" problem that Truth-in-Lending Simplification intended to correct will reappear. Consequently, consumers will be more confused.
- The "true cost of credit" will not be revealed. Fees and charges are often contingent on unknown future events.
- Up to 7 billion pages of complex data will be generated at a cost to consumers of almost one billion dollars a year.
- The total information load will exceed 7 trillion words per year.
- Shifts in the solicitation industry to handle this load may cost thousands of unskilled, part-time workers their jobs.

\* At least 7 bills are now pending or in draft form, including HR 4197 (Schumer/Roth), S 1922 (D'Amato) and S 2140 (Dodd).

NOT ALL PROPOSED BILLS WILL CREATE INFORMATION OVERLOAD. SOME REQUIRE ONLY A FEW NEW DISCLOSURES. WE SUPPORT THOSE.

WE ALSO RECOMMEND A PROVISION REQUIRING THAT ALL POSSIBLE COSTS BE DISCLOSED IN THE CONTRACT OR AGREEMENT. THIS IS NOT NOW BEING DONE IN MANY CASES.

MODEL DISCLOSURE REQUIREMENT  
UNDER PROPOSED LEGISLATION

1. Application Fee.

A payment of \$5.00 must accompany the completed application.

2. Membership Fee.

An annual fee of \$8.00 for each account will be prorated to the expiration date of the card and then charged annually thereafter.

3. Additional Card Fee.

A fee of \$5.00 for each additional card requested will be billed on the next statement after the card is issued.

4. Card Replacement Fee.

A replacement fee of \$5.00 will be assessed for each card lost or stolen. This fee will be billed on the statement following the issuance of the card.

5. NSF Check Charge.

A charge not to exceed \$6.00 may be imposed for each check which you submit for payment on your account when that check is returned to our office unpaid, because of insufficient funds or for any other reason.

6. Collection Notice Charge.

A charge of \$2.50 will be made to your account if we have to send you a notice of late payment. We may send such notices when your payment becomes 10 days late.

7. Collection Call Charge.

A charge of \$5.50 may be made to your account if we have to call you to request payment or determine why payment has not been received by us. We may call you whenever your payment is more than 14 days late.

8. Collection Visit Charge.

A charge of \$25.00 may be made to your account if we have to send an account representative to request payment or to determine why payment has not been received by us. We may do this whenever your payment is more than 30 days late.

9. Attorney's Fees.

If we have to use an attorney to get monies you owe us on the account, or to otherwise enforce our rights, then you will be required to pay the fees and costs of the attorney.

10. Court costs.

If we have to sue you, or otherwise go into court to collect our money or protect our rights, then you will be required to pay all court costs.

11. Credit Report Charge.

If we open an account for you based on a credit report, then a one-time charge of \$3.50 will be made to your first statement.

12. Document Copy Charge.

A charge of \$2.00 may be imposed for copies of each document that you request in connection with the account. This charge is not imposed if the copy is requested for resolution of a billing error.

13. Overlimit Penalty.

An overlimit penalty will be charged on amounts in excess of your credit limit, whenever the new balance on closing date is 10% or more over your approved limit. This penalty will be 1% of the amount overlimit or \$5.00, whichever is greater.

14. Late Payment Charge.

A single late payment charge will be imposed on minimum payments that are not paid within 5 days after the payment due date, based on your postmark. This charge will be 5% of the minimum payment due or \$5.00, whichever is greater.

MODEL DISCLOSURE REQUIREMENT  
UNDER PROPOSED LEGISLATION

15. Cash Advance Setup Fee.

On cash advances in the amount of \$500.00 or less a single, nonrecurring setup fee will be charged. This fee will be 4% of each advance, except that it shall not be less than \$4.00 nor more than \$15.00 for any advance.

16. Cash Advance Finance Charge.

The finance charge will be the sum of the products of the following:

- (A) The total of transactions for cash advances of \$500.00 or less multiplied by a setup fee of 4% (minimum \$4.00, maximum \$15.00 per transaction), and
- (B) The average daily balance of cash advances multiplied by the number of days in the billing cycle and applying to that product the greater of the following interest rates:
  - (i) A daily periodic rate of .0328767% (ANNUAL PERCENTAGE RATE 12%), or
  - (ii) A daily periodic rate determined as follows: Add 4 percentage points to the equivalent coupon issue yield of the average bill rate for 26-week Treasury Bills (as determined at the first bill market auction conducted during the preceding calendar month) which is in effect on the last day of your billing cycle and divide by 365. This is a variable rate that may change monthly.

17. Finance Charge For Purchases.

The finance charge for purchases will be determined as follows: The average daily balance of purchases multiplied by the number of days in the billing cycle will have applied to it the greater of the following interest rates:

- (i) A daily periodic rate of .0410958 (ANNUAL PERCENTAGE RATE 15%), or
- (ii) A daily periodic rate determined as follows: Add 4 percentage points to the bank's basic rate and divide by 365. The bank's basic rate is a variable rate that the bank calculates based on market conditions and may change from time to time. Your finance charge will be based on the basic rate in effect on the last day of your billing cycle.

18. Overall Finance Charge.

Your overall finance charge will be the sum of the cash advance finance charge and the finance charge for purchases for the billing cycle.

19. Liability For Unauthorized Use.

You may be liable for the unauthorized use of your credit card. You will not be so liable for unauthorized use that occurs after you notify us orally or in writing of the loss, theft or possible unauthorized use of your card. In any case your liability will not exceed \$50.00 for unauthorized use.

20. Currency Conversion Fee.

If you have transactions on the account in a currency other than U. S. Dollars they will be billed on your statement converted to U. S. Dollars at the foreign exchange rate in effect at the acquiring institution on the date the transaction is processed. A fee of \$0.50 will be charged for each conversion.

21. Cancellation Charge.

If we have to cancel your account for any reason we will add a charge of \$25.00 to the amount you owe us.

22. Uncollected Check Charge.

We will guarantee payment of any check drawn on us up to \$100.00 drawn to the order of a retailer if: (i) our check guarantee agreement is printed on the back of your card, (ii) your last name as printed on the check is the same as shown on your card, (iii) the number of your credit card is written on the check, and (iv) the card is not expired. If we pay a check based on this guarantee and are unable to collect on the check through our normal collection procedures, then the uncollected balance of the check may be added to your balance as a cash advance. If we do this we may also add a charge of \$15.00 to your account balance.

23. Default Charge.

If default occurs on this agreement we can, at our option, demand that you pay us all sums that you owe us. In this event, you must also pay a default charge of 5% of the unpaid balance.



MODEL DISCLOSURE REQUIREMENT  
UNDER PROPOSED LEGISLATION

24. Optional Insurance Fees.

Our insurance company offers cardmembers under the age of 65 low-cost group life and disability insurance. The purchase of this insurance is voluntary and is not required to obtain credit. This insurance covers your account balance and any other amounts due us in the event of your death and/or disability. The monthly premium will be billed directly to your account. Current rates and options are as follows:

( ) Life and disability insurance on applicant alone: \$0.29 per \$100.00 of monthly account balance: \$0.08 for life, \$0.21 for disability.

( ) Joint life on applicant and co-applicant, plus disability insurance on applicant only: \$0.349 per \$100.00 of monthly account balance: \$0.139 for life, \$0.21 for disability.

25. Special Statement Requests.

For a fee of \$2.50 you can obtain a special statement at any time during your billing cycle. This fee will appear at the end of your next complete cycle.

26. Balance Inquiry Fee.

A fee of \$1.00 will be charged for each balance inquiry. Getting both your cash advance balance and your balance of purchases counts as one inquiry.

27. Travellers Checks.

You may use your card to purchase travellers checks at our automatic teller machines. The charge will be 1% of the total sale, with a minimum of \$3.00 for U.S. funds. Foreign funds checks are only available at our offices.

28. Automatic Payment From Another Account.

We can arrange automatic payment of your account from your savings or checking account. You may pay either the minimum payment due or a preset amount, as long as it is greater than your minimum due. We charge you a \$10.00 setup fee for this service and \$2.00 for each automatic payment. Fees are posted in the cycle following payment.

29. Private Club Membership Fee.

For a fee of \$25.00 per year you can become a full nonresident member of 100 private city clubs, country clubs and athletic clubs located more than 50 miles from your home. This fee is prorated to the expiration date of the card and then charged annually thereafter.

30. Travel Accident Insurance Fee.

Approximately \$0.366 of your membership fee is for \$100,000 travel accident insurance on yourself, your spouse and dependent children under the age of 23.

THIS LIST IS NOT INTENDED TO BE COMPLETE. THERE ARE MANY OTHER FEES AND CHARGES PRESENTLY APPLIED TO OPEN-END CREDIT ACCOUNTS.

By: Dr. David E. Wojick & Mrs. Diane W. Adams

The Lutra Duo  
P.O. Box 123  
Markham VA 22643

(703) 364-1987

CONSUMER COMPREHENSION WILL GO DOWN, NOT UP

Full disclosure of complex credit terms was tried under the original Truth in Lending law — it failed! Here are some quotes from the hearings on simplification that explain why we shouldn't try to disclose too much at once:

"Studies on consumers' use of labeling disclosure indicate that the typical shopper often does not read labels when they are inundated with information. These studies suggest that five to nine items of information are all the consumer can absorb in a short time." (Our underline)

"These developments would suggest that the consumers are not receiving shopping benefits from truth in lending and the over-regulation of credit grantors is diminishing consumer choices in the marketplace of different sources for financing retail purchases." (Our underline)

Senator Schmitt

"At any rate, it was burdensome on lenders. There is no question about that. It required a long form, and it was very confusing for consumers. And as a result, I think the consumers benefited less than they should from truth in lending, and I think Senator Schmitt has brought out a good example of why."

"In conclusion, let me say that my bill would require that consumers get clear, simple disclosure written in everyday language." (Our underline)

Senator Proxmire

"Therefore, our approach is to focus on disclosure of the most essential elements of the contractual relationship with the creditor, emphasizing those in a way consumers are most likely to understand, and reserving many other aspects of the credit transaction to the contract documents themselves."

"We believe that clarity is better served if only the most important terms are emphasized on the disclosure statement. The rest will be in the contract, just as they are now." (our underline)

Governor Jackson  
Federal Reserve Board

Source: Hearings on Truth-in-Lending Simplification Act,  
July, 1977

THE FED SAYS "TOO MUCH IS TOO MUCH"

After eight years experience and extensive research, the Federal Reserve Board had this to say about too much disclosure:

"Whatever different meanings 'Truth in Lending simplification' may connote, almost everyone seems to agree that some reduction in disclosure is needed, both to relieve the creditors' compliance and litigation burden and also to avoid the 'information overload' phenomenon for consumers themselves."

"Behavioral research suggests that when confronted with more than a very limited number of 'bits' of information -- no more than 5 to 9 -- consumers may stop trying to read or understand the offered material and simply disregard it. This phenomenon of rejection is referred to as 'information overload'. The argument is made that the sheer mass of the information offered on present disclosure statements can produce a kind of information overload for some groups of consumers, with the result that they may fail to read or comprehend any of it."

"(In the fed proposal)...Eliminated would be all the computation and component disclosures and some information about contract terms. The term disclosures that would remain would be summary disclosures. ... The Board recognizes that eliminating all disclosure of computational steps and component charges may make administrative enforcement somewhat more difficult. But the Board believes that the value to consumers of reducing information overload outweighs this difficulty."

(Source: Memorandum analyzing issues in Board's draft bill on simplification of Truth in Lending. June 28, 1977)

THE "TRUE COST OF CREDIT" WILL NOT BE REVEALED

Advocates of the 'full disclosure during solicitation' bills say they are needed to get the "true cost of credit" disclosed to the consumer. This is an illusion. All that gets disclosed under these bills is a very complex and lengthy set of computation rules, plus a host of minor fees and charges that are contingent on how the account is used.

None of this information is a known cost of credit to consumers. The only known costs are already disclosed -- APR, membership fee (if any), and insurance premiums, if elected. To derive costs from any of the other information each consumer will have to know his or her future. How many times will the payment be late? How late? How many times will you need a copy of a document? How many cash advances will you get that are for less than \$500? How many NSF checks will you send to pay your bill?

Unless all of this -- and a great deal more -- is known in advance, none of this massive disclosure is of any use in comparing accounts. Its use is in operating the account once you have it. That is why the proper place for all this cost information is in the disclosure you get when you open the account. It helps you make decisions as to how best to use the account.

Here are two analogies. Right now the auto makers disclose an estimated mileage per gallon figure for each car, and the refrigerator makers disclose a similar estimate of energy consumption. These estimates are like the APR -- a baseline for comparison. But your mileage may vary from the estimate, and your refrigerator may use more energy, depending on how you use the products. Should we require every car to have a label that explains all the factors and equations needed to figure out what you actual gas consumption will be? Should each refrigerator have one side covered with a similar explanation of energy conservation? No, what we do is give you a booklet that explains these factors when you buy the product. Likewise, you get the detailed operational rules of your credit card account explained when you open it; that's when you need it.

The notion that there is a knowable 'True Cost Of Credit' that is not now being disclosed is an illusion. There are simply known costs and unknown, contingent costs. The known costs are already being disclosed. The so-called true cost of credit will not be revealed by passage of the proposed bills. There is no such thing.

OVERDISCLOSURE WILL COST CONSUMERS NEARLY ONE BILLION \$ A YEAR

Simple arithmetic based on industry cost figures tell us that all this disclosure will cost about \$930 million more a year. That adds up to nearly \$10 for every new card account. The most likely way for creditors to handle this increase is to increase fees to cardholders.

1. New card accounts per year.

| <u>Type of Card</u> | <u>Millions of new<br/>card accounts/year</u> | <u>Estimate basis</u> |
|---------------------|-----------------------------------------------|-----------------------|
| MasterCard & Visa   | 20                                            | Industry sources      |
| Travel              | 5                                             | Industry sources      |
| Gasoline            | 30                                            | MC/V times 1.5        |
| Retail              | <u>40</u>                                     | MC/V times 2.0        |
| Total               | 95 million                                    |                       |

2. Solicitations

Take-ones are found in racks and stacks in stores, banks, airports, gas stations, etc. Based on industry estimate of 50 take-ones for every new card account actually opened, there are 4.8 billion "take-ones" a year. Based on an industry estimate of 20 direct mail solicitations per new account, there are about 2 billion per year. Note we are not double counting. If we used the number of new accounts actually due to each form of solicitation the ratios would be higher to give the same total number. Therefore, there are about 7 billion solicitations per year.

3. Annual estimated cost for increased disclosure.

|                         |                             |
|-------------------------|-----------------------------|
| "Take-one".....         | \$500 million (\$100/1,000) |
| Direct mail increase... | \$430 million (\$215/1,000) |
| Total.....              | \$930 million               |

4. Additional costs

The disclosure bills could force lenders to discontinue magazine and newspaper advertising of cards, when accompanied by an application, because of the huge added costs of disclosures. This, in turn, will increase the cost of attracting new customers through direct mail marketing.

## ASSUMPTIONS BEHIND OUR ANNUAL COST ESTIMATE

### 1. New card accounts per year.

Industry sources provided us with the estimates for MasterCard, Visa and travel Cards. The ratios we used to estimate gasoline and retail annual accounts are based on our own card holdings, as we think we are probably typical. It may be that the turnover rate in MC/V and travel cards is higher than in gas and retail, due to heavier marketing, in which case our estimate is high. On the other hand, most gas and almost all retail cards are of a regional nature and would be frequently changed in our mobile population. So our estimate may well be very low, as well.

The overall figure probably also reflects the large numbers of younger people now settling down, getting lots of cards and being parents. Note that we have not included the many millions of non-card credit accounts that retailers, co-ops, etc., have nor the additional millions of non-card check credit, overdraft protection, etc., accounts that the banks offer. Some proposed bills include these though and the cost for these bills is much higher than our estimate.

### 2. Solicitations.

The industry estimates for ratios between new accounts and number of solicitations of each sort are for MC, Visa and Amex. We have assumed that these ratios hold for all card accounts. Department stores and gasoline companies certainly do a lot of direct mail solicitation and distribute take-ones in their retail outlets as aggressively as do the banks, or so it seems. Obviously, further research will improve this figure. Our intent is merely to make a rough estimate, what engineers call a ROM or rough order of magnitude estimate.

### 3. Annual estimated cost for increased disclosure.

For take-ones the \$100/1000 increase in cost is based on the premise that at least one additional sheet of paper will be needed to carry all the disclosures. This in turn, we assume, requires an envelope as well as collation and stuffing. Industry sources tell us that the cost for these additions is \$40/1000 for the extra sheet, \$40/1000 for the envelopes, and \$20/1000 for collation and stuffing. Some firms may go to a very large one page take-one, but this takes very special equipment and may be equally expensive. The direct mail cost is based on adding another sheet and a second stamp to carry it.

If these costs seem large, remember that we are increasing the amount of disclosure by about 10 times. Now the top 3 items are disclosed, as opposed to the typical 30 or so total items for an account. This is about 2 to 3 times the total text on the typical solicitation.



IMPACT: LOST JOBS

It is highly unlikely that the credit industry will simply spend another billion dollars a year, send out 7 billion new disclosures and hike its prices. Rather, we can expect changes in the way that solicitation is done because, as the Fed and market researchers tell us, people don't like information overload when they shop.

The experts we talked to agreed that this new disclosure burden would lead to a drastic curtailment of take-one solicitations.

The reason is simple. Right now take-one marketing is an easy and cheap mode of mass communication. Adding 1000 or more words of complex disclosure destroys the efficiency of the medium. The bills now proposed would prevent consumers from obtaining a simple explanation of an account together with an application.

Who loses?

Much of the distribution of take-one solicitations is done by low-skilled, part-time employees. These include housewives, mothers with children in school, students and teenagers. In fact, these four groups probably make up the majority of workers in the take-one solicitation distribution industry.

Envelope stuffing, on the other hand, has become largely automated so the shift to direct mail will not open up new jobs to the same disadvantaged groups. Industry sources estimate the take-one distribution cost to be about \$200 million. The typical part-time worker who distributes to the racks makes perhaps a wage rate of \$3000 per year. If just 15% of the distribution cost is part-timers then there are 10,000 jobs to be lost. If 50% then 33,000 jobs are on the line.

Who wins?

The primary winners are the printers and the U.S. Post Office. The printers will have up to 7 billion more pieces of paper to print. But, this does not add any significant number of jobs since printing is a highly automated process. For the Post Office, the 2 billion or so direct mail solicitations it now handles each year will get heavier. Plus we expect another 2 or 3 billion pieces of mail each year when the industry shifts away from the take-one mode of solicitation.

THE EFFECTS OF PROPOSED CREDIT CARD INTEREST  
RATE CEILINGS ON CONSUMERS AND CREDITORS

Staff

Board of Governors of the Federal Reserve System

April 1986

## TABLE OF CONTENTS

| <u>Chapter</u>                                                                                                          | <u>Page</u> |
|-------------------------------------------------------------------------------------------------------------------------|-------------|
| I. INTRODUCTION, SUMMARY, AND CONCLUSIONS .....                                                                         | 1-1         |
| Introduction .....                                                                                                      | 1-1         |
| Summary .....                                                                                                           | 1-2         |
| Conclusions .....                                                                                                       | 1-8         |
| II. THE EFFECTS OF PROPOSED RATE CEILING REGULATIONS ON THE<br>PROFITABILITY OF BANK AND RETAIL CREDIT CARD PLANS ..... | 2-1         |
| Bank Credit Card Profitability .....                                                                                    | 2-5         |
| Retail Credit Card Profitability .....                                                                                  | 2-8         |
| Implications for Adjustments by Credit Card Issuers .....                                                               | 2-9         |
| Scope of Adjustments Likely to be Associated with Proposed<br>Rate Ceilings .....                                       | 2-9         |
| III. CREDIT CARD HOLDING AND USE.....                                                                                   | 3-1         |
| Credit Card Holding.....                                                                                                | 3-1         |
| Characteristics of Credit Card Users .....                                                                              | 3-4         |
| Consumer Credit Card Repayment Practices .....                                                                          | 3-11        |
| IV. POSSIBLE ADJUSTMENTS BY CREDIT CARD ISSUERS TO MORE<br>RESTRICTIVE RATE REGULATIONS .....                           | 4-1         |
| Adjustments in the Availability of Services .....                                                                       | 4-1         |
| Tightening credit standards .....                                                                                       | 4-1         |
| Reducing or eliminating services .....                                                                                  | 4-3         |
| Adjustments in the Pricing of Services or Merchandise .....                                                             | 4-3         |
| Curtailling grace periods .....                                                                                         | 4-3         |
| Increasing merchandise prices .....                                                                                     | 4-5         |
| Annual fees and transaction fees .....                                                                                  | 4-6         |
| Penalty fees .....                                                                                                      | 4-7         |
| Service charges .....                                                                                                   | 4-7         |

| <u>Chapter</u>                                                                               | <u>Page</u> |
|----------------------------------------------------------------------------------------------|-------------|
| Unpredictability of Adjustments in Availability and<br>Pricing of Credit Card Services ..... | 4-8         |
| V. EVIDENCE OF THE EFFECTS ON CONSUMERS OF CREDIT CARD RATE<br>RESTRICTIONS.....             | 5-1         |
| Effects on Credit Availability .....                                                         | 5-1         |
| Effects on Bank Credit Card Availability .....                                               | 5-3         |
| Effects on Retail Store Credit Card Availability and<br>Product Prices .....                 | 5-10        |
| APPENDIX A: REFERENCES .....                                                                 | A-1         |
| APPENDIX B: MULTIVARIATE ANALYSIS OF BANK CREDIT CARD HOLDING .....                          | B-1         |

## Chapter 1

## INTRODUCTION, SUMMARY, AND CONCLUSIONS

Introduction

A number of observers recently have noted that interest rates on credit card debt have changed little since the early 1980s, even though most other interest rates have fallen substantially. It has been argued that interest rates charged on credit cards are excessive in light of the level of current funding costs of card issuers. As a result, several bills have been introduced in the Congress to establish a federally mandated ceiling on credit card interest rates. Each of the bills currently under consideration calls for a nationwide floating rate ceiling that would supersede state-imposed interest rate limitations that generally are less restrictive.

Considerable evidence has been accumulated over the years about the effects on both consumers and creditors of legislatively established interest rate ceilings. This staff study focuses on issues raised by proposed federal limitations on credit card interest rates. The study emphasizes the likely effects of such rate ceilings on the availability of credit card services to different groups of consumers. It also explores the consequences for consumers of other possible creditor responses to credit card rate constraints, including modifications of nonrate prices of credit card services, of other terms on credit card accounts, and of product prices.

The study is divided into five chapters. This chapter briefly discusses the content of each section of the study and summarizes the principal findings. The analysis begins in chapter 2 with an examination of the profitability of bank and retailer credit card plans. These findings help to assess whether creditors might be able to absorb the impact of tighter rate ceilings on profits or whether they would be forced to make adjustments to cut costs and

boost nonfinance-charge revenues. Chapter 3 presents information obtained from a series of consumer surveys on credit card holding and use patterns of U.S. families. Such information provides the basis for analyzing the likely effects on consumers of a national credit card rate ceiling. Chapter 4 discusses various adjustments that card issuers might make in their credit card operations in response to the establishment of a federally mandated rate ceiling and how these changes might affect card holders with different patterns of credit card usage. Finally, chapter 5 summarizes empirical investigations of the effects of state-imposed rate ceilings on consumer access to and use of consumer credit.

#### Summary

Profitability is a key issue in evaluating the effect of any nationwide rate ceiling on credit card plans. Some advocates of credit card rate controls have suggested that profits on credit card plans are large enough to absorb the effects of finance rate restrictions without any substantial adverse impact on either the credit card services offered or the prices charged for those services. However, for the period 1972 to 1984, average net earnings before taxes on bank credit card plans were low, both in absolute terms and relative to returns on other major types of bank lending, despite atypically high returns in the very recent past. Moreover, retailer credit card plans operated at a loss in each of the two years for which profitability studies are available.

Furthermore, estimates suggest that rate ceilings on bank credit cards, such as those proposed in recent Senate legislation, would have changed relatively low profits on bank credit card plans to outright losses in most years from 1972 through 1984, if the volume of lending and the pricing of credit card services were unchanged. Faced with such a drain on earnings, bank



credit card issuers undoubtedly would take steps to cut costs and to boost revenues from sources other than finance charges. These estimates suggest that the pressures to make cost and revenue adjustments might become quite intense, were the proposed rate ceilings to be enacted.

Patterns of consumer holding and use of credit cards would significantly influence the incidence of any actions taken by credit card issuers. About two-thirds of American families currently hold some kind of credit card. Retail store and bank credit cards are the most widely held kinds of credit cards. About 57 percent of families have retail store cards, and 42 percent hold bank credit cards; approximately 62 percent have at least one credit card of either type. Holders of these credit cards are the individuals most likely to directly benefit from finance rate controls, since both types of cards typically allow payments to be deferred.

Credit card holding and use generally increases with family income, with the educational attainment of the head of the family, and with the age of the family head up to retirement age. Bank and retail store credit card use is particularly prevalent among higher income families and those headed by a college graduate. By contrast, a much smaller proportion of families with incomes below \$10,000 use bank or retail store credit cards.

Although about 62 percent of all families hold a credit card that permits payment to be deferred, the way that these cards are used varies substantially among families. Successive consumer surveys have identified two contrasting patterns of card usage. "Convenience users" are individuals who use credit cards primarily for the convenience that they afford in conducting transactions. Such users typically pay off their balance during the interest-free grace period and usually avoid incurring finance charges. "Borrowers" are

individuals who typically do not pay off their full credit card balance during the interest-free period, and therefore often do pay finance charges.

Nearly half of bank and retailer credit card users appear to be convenience users. The remaining card users--about 32 percent of all families--can be considered borrowers. The likelihood that a credit card holder is a convenience user rises with age and income. Although the probability of being a convenience user increases at higher income levels, it is important to recognize that at least two-fifths of families in every income group are convenience users.

As previously mentioned, it seems likely that credit card issuers would try to cut their costs in response to the imposition of tighter rate ceilings. To do so, card issuers would probably impose tighter credit standards to help lower collection expenses and loan charge-offs. Similarly, card issuers might narrow the range of services often provided as enhancements to their basic credit card plans. In extreme circumstances, credit card operations might be discontinued entirely, as some card issuers did during the early 1980s when pressures on profits became severe. Thus, a little recognized but likely drawback of instituting more restrictive credit card rate controls would be denial of credit card services to consumers because they could not satisfy tightened standards for obtaining credit card accounts. Less affluent borrowers with limited access to other sources of credit seem likely to be most heavily affected by any curtailment in the availability of credit card services. Such borrowers may be forced to rely on more expensive or less convenient sources of credit.

Another means by which credit card issuers might seek to offset reduced revenue due to lower finance rates is by changing the terms of credit

card plans and raising other prices for credit card services. Such actions could include shortening or eliminating the interest-free grace period, increasing the fees that merchants pay banks to process credit card sales slips and to collect balances due, initiating (or increasing) annual fees for all card holders or fees for each credit card transaction, charging penalty fees under certain conditions, and establishing (or increasing) charges for particular services. For bank credit cards, charges could be levied for processing applications, issuing monthly statements, and providing cash advances. For retailers with credit card plans, in addition to fees for credit-related services similar to some of those mentioned for bank cards, charges also could be applied for customer services that previously have been provided without explicit charge. Depending on competitive conditions and the type of products sold, retailers might raise merchandise prices somewhat to help offset lower finance charge revenues on their own cards or to compensate for any increase in merchant discount fees on third-party credit card plans.

The effects of such repricing actions on particular types of consumers would depend, of course, on the combination of steps undertaken by card issuers. Higher annual fees and transaction charges would be paid by all credit card users. Such measures would shift the incidence of some costs from borrowers to convenience users of credit cards. However, this possible effect should be evaluated keeping in mind that nearly half of lower income credit card holders are convenience users. By contrast, late fees and penalty fees for exceeding credit limits would likely fall mainly on borrowers rather than on convenience users of credit cards, directly offsetting the benefit they realize from reduced finance charges. Elimination of the interest-free grace period would mainly affect convenience users because they could no longer avoid

paying finance charges. However, borrowers who sometimes pay off their entire credit card balance at one time also would incur some additional finance charges if interest-free grace periods were eliminated.

Increases in some retail prices--either to help offset reduced finance charge revenue on retailer credit card plans, or as a consequence of higher merchant discount fees--would affect all purchasers of such merchandise. With higher retail prices, customers who pay for merchandise in cash would likely subsidize consumers who use credit cards. Included among the cash customers, of course, would be lower income families who did not qualify for credit card services.

Credit card issuers would be apt to make a number of adjustments in credit card availability and pricing in response to the imposition of stringent nationwide credit card rate ceilings. The changes adopted by particular credit card issuers would depend in part on how they believed their customers would react. Thus, the benefits and costs to particular groups of consumers cannot be precisely predicted. However, as already discussed, the advantage to borrowers of lower finance rates would likely be diminished if lenders moved to cut costs and to increase other types of revenue. Convenience users probably would experience a net increase in the cost of using credit card services. All credit card customers and applicants likely would face a more complex credit card market as credit card issuers moved away from fairly well standardized credit terms toward differing grace periods, balance computation methods, and new kinds of fees and service charges.

Because the credit card market is complex, the results of imposing restrictive nationwide rate ceilings cannot be foreseen precisely. Nevertheless, evidence about consumer and creditor experience in different state

regulatory climates demonstrates that concern about restricted access to and repricing of credit card services--especially with respect to lower income consumers--is not misplaced. During the past twenty years, research repeatedly has shown that restrictive rate ceilings on consumer credit have been associated with tighter credit standards by lenders. For example, several studies found that a greater proportion of consumer installment loan applications was accepted when the legally permitted finance rate was higher because creditors typically employed less selective credit standards.

Other studies specifically examined the effects of rate ceilings on the availability of credit card services. Surveys conducted in states with substantially different credit card rate limits have shown that consumer access to bank credit card services was limited by tighter rate ceilings. Where rate ceilings were low, families at the lower and lower-middle income levels were less likely to hold bank cards than similar families living in states with higher credit card rate limits. However, higher income families were equally likely to hold bank credit cards regardless of the rate ceilings that applied where they lived. These findings indicate that restricted availability of credit card services mainly affected less affluent families.

Some studies have shown that retail stores with credit card plans tended to rely on increases in merchandise prices to help offset any reduction in finance charge revenue, and therefore were less likely than bank card issuers to ration credit in response to tighter rate ceilings. As mentioned, consumer survey evidence indicated that a substantially lower proportion of residents in states with low credit card rate ceilings held bank credit cards, as compared with residents of states that had less restrictive credit card rate limits. In contrast, the proportion of the population holding retail store

cards was the same in states with low rate ceilings as in states with less restrictive regulations. Moreover, the prices of products that usually are purchased on credit were higher in states with low credit card rate ceilings than they were in states with higher interest rate limits. These findings support the view that some retail card issuers are likely to raise merchandise prices to offset the effects of low interest rate ceilings, thereby easing pressures to tighten credit standards.

#### Conclusions

Under current credit card usage patterns, about 32 percent of all families incur credit card finance charges and would stand to benefit somewhat from a federally mandated reduction in credit card interest rates. However, responses by credit card issuers to rate ceilings would diminish the benefit of lower finance rates to some of these families, if issuers tightened credit standards and raised nonrate prices of credit card services. Furthermore, nearly all consumers--not just credit card holders--might be adversely affected if finance rates were limited by stringent rate ceilings such as those proposed in recent legislation. Estimates suggest that the pressures to make cost and revenue adjustments might become quite intense, if the proposed rate ceilings were enacted. In assessing the incidence of such adjustments in credit card availability and pricing, it is important to keep in mind that at every income level convenience users constitute a large proportion of credit card users; in particular, nearly half of lower income credit card users are convenience users.

Card issuers could be expected to react to the imposition of a federally mandated credit card rate ceiling in much the same way that they have



responded to relatively stringent rate regulations in some individual states. In an effort to cut expenses, they would be likely to tighten credit standards for new credit card applicants--an action that research evidence shows would mainly affect families at lower levels of income, who typically have limited access to other sources of credit. Also, card issuers likely would increase nonrate prices for credit card services, in order to offset reduced finance charge revenue. Some of these actions--such as initiating (or increasing) annual fees or charges for each transaction, and levying fees for particular services to account holders--would impose costs on all credit card users. Other repricing measures--such as eliminating the interest-free grace period--would primarily result in new charges for all convenience users, who could no longer avoid paying finance charges. However, borrowers who sometimes pay off their entire balance and take advantage of interest-free grace periods also would incur higher finance charges. Still other changes in credit card pricing would fall mainly on borrowers. These actions include charging penalty fees for late payments and for exceeding credit limits.

Finally, some adverse consequences of nationwide credit card rate ceilings could be felt by all consumers, including those that do not use credit cards. Retailers might increase some merchandise prices--either to help offset reduced finance charge revenue on retailer credit card plans, or as a result of higher merchant discount fees on bank credit cards and other third-party credit card plans. Higher retail prices could result in customers who usually pay in cash--including lower income families who cannot obtain credit cards--providing a subsidy for buyers who use credit card services.

## Chapter 2

THE EFFECTS OF PROPOSED RATE CEILING REGULATIONS ON THE  
PROFITABILITY OF BANK AND RETAIL CREDIT CARD PLANS

The nationwide credit card rate ceilings suggested in some current legislative proposals would be more restrictive, on the whole, than the maximum credit card rates that exist in many states. Charts 2.1 and 2.2 illustrate this point for bank credit cards by comparing an average of typical rates charged on bank credit cards during the period from 1972 through 1985 with the ceiling rates that would have applied under each of two bills currently being considered in the Senate.<sup>1/</sup> The average rate series, of course, reflects the effects of any state rate ceiling regulations in force during the period. It seems clear that the applicable limits under either bill would have substantially reduced the rates that card issuers could have charged, and therefore--in the absence of compensating changes--would have cut bank credit card revenues.

Some advocates of national ceilings on credit card rates appear to assume that profits on credit card plans are large enough to absorb substantial rate reductions with little adverse impact on the quantity and the quality of available credit card services. Nor do these proponents seem to expect that tighter rate controls would exert upward pressure on nonrate prices for bank or retail credit card services, or on retail merchandise prices. On closer examination, however, historical evidence suggests that credit card profits have been fairly low, and therefore significant changes in the quantity, quality, and pricing of credit card services are likely to occur if tighter rate ceilings are imposed.

<sup>1/</sup> The provisions of S.1603 and S.1922 that specify how the proposed rate ceilings would be calculated are summarized in table 2.1. The bank credit card finance rate is an average of typical credit card rates as reported quarterly to the Federal Reserve by a sample of commercial banks.

Chart 2.1  
BANK CREDIT CARD FINANCE RATE COMPARED  
WITH THE S.1603 RATE CEILING FORMULA

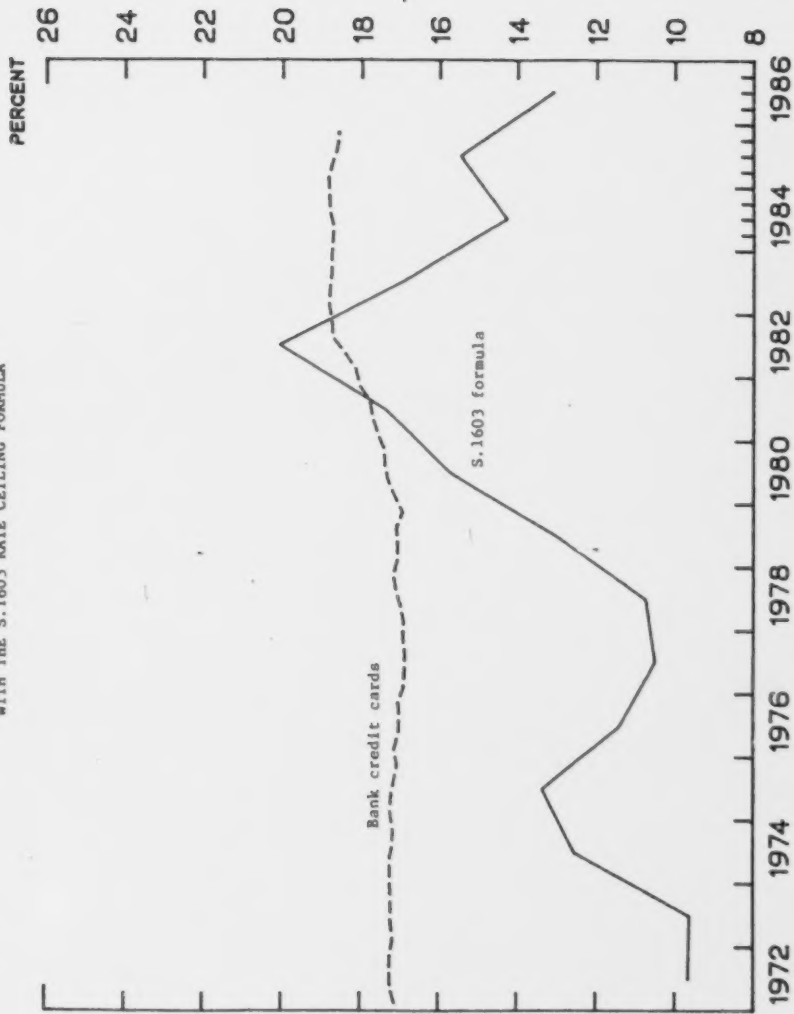


Chart 2.2  
BANK CREDIT CARD FINANCE RATE COMPARED  
WITH THE S.1922 RATE CEILING FORMULA

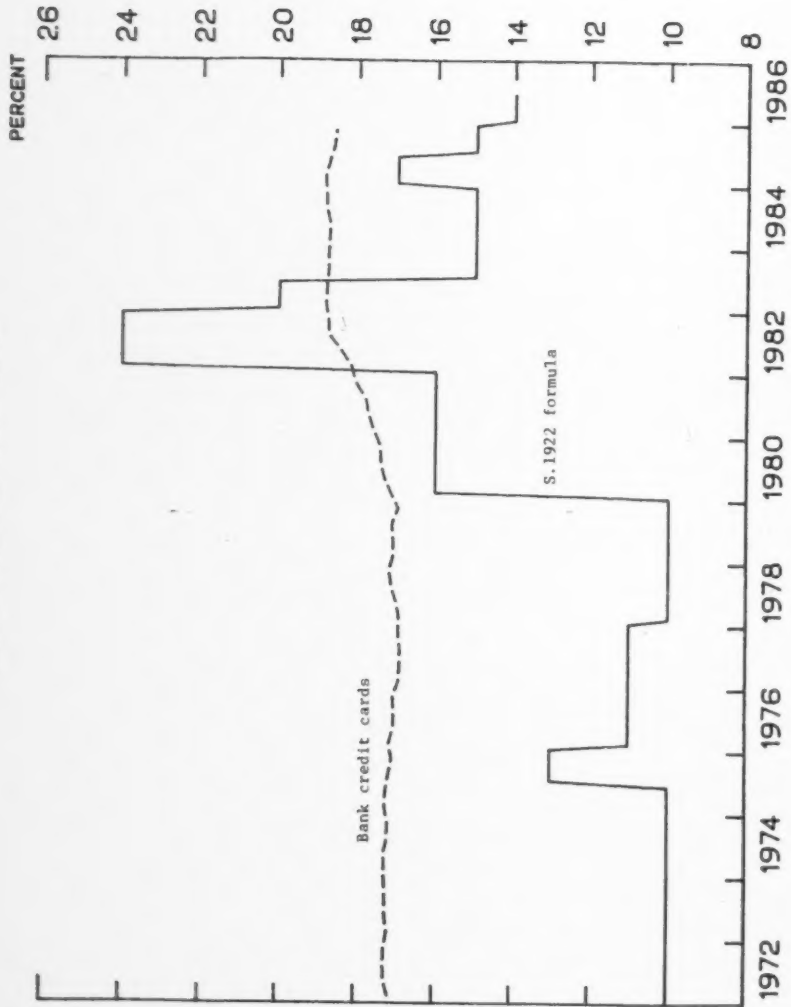


Table 2.1

CREDIT CARD RATE CEILING LEGISLATION UNDER  
CONSIDERATION IN THE SENATE IN APRIL 1986

| Rate ceiling<br>formula | S.1603<br>National Credit Card<br>Protection Act           | S.1922<br>Credit Card Holder<br>Protection Act                                                            |
|-------------------------|------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| Markup                  | 5 percentage points                                        | 4 percentage points                                                                                       |
| Index                   | Six-month Treasury bills                                   | IRS rate payable on overdue in-<br>come tax payments and on income<br>tax refunds                         |
| Index calculation       | Average investment yield<br>for preceding calendar<br>year | Calculated by IRS from prime<br>rate charged by commercial banks<br>during an earlier six-month<br>period |
| Current ceiling         | 13.085 percent, for all<br>of 1986                         | 14 percent, for January through<br>June 1986                                                              |

Bank Credit Card Profitability

Data for bank credit card plans from the commercial bank Functional Cost Analysis (FCA) program for the period 1972 through 1984 show that annual net earnings before taxes averaged only 1.68 percent of balances outstanding (table 2.2).<sup>1/</sup> In comparison, net returns on other major types of commercial bank lending were significantly higher, on average, than bank credit card earnings over the 1972-84 period.<sup>2/</sup>

In some years between 1972 to 1984, of course, profits on bank credit card plans exceeded the 1.68 percent average level. One such year was 1984, the most recent period for which data on net returns are available. Net earnings before taxes in 1984 averaged 3.4 percent of credit card receivables, the highest rate of net earnings during the 13-year period (chart 2.3). In addition,

<sup>1/</sup> The FCA is conducted each year by the Federal Reserve System, using data supplied voluntarily by about 500 commercial banks that vary widely in size. However, since participation is voluntary and the reporting banks are not selected at random, the institutions do not provide a representative cross section of all U.S. commercial banks.

One difference from the entire population of commercial banks is that no large money center banks take part in the FCA program. Also, one study has suggested that FCA banks were somewhat more aggressively managed and had lower cost-to-asset ratios in comparison with the universe of U.S. commercial banks. See Arnold A. Heggstad and John J. Mingo, "On the Usefulness of Functional Cost Analysis Data," Journal of Bank Research (Winter 1978), pp. 251-56. In addition, there is considerable variation from year to year in the banks that participate in the FCA sample.

Accordingly, conclusions drawn from FCA data are likely to be more reliable if they are based on results for several years rather than on data for a single year that might be influenced by changes in the sample or by unusual circumstances.

<sup>2/</sup> Commercial banks typically offer a variety of consumer financial services. In addition to the pressure exerted on credit card profits by apparently intense competitive conditions, some institutions may have accepted below-par returns on credit card plans with the expectation that credit card customers would use other, more profitable bank services. Also, some banks may have accepted lower returns on credit cards to establish a customer base for offering electronic payment services. Such services may be an important element of bank strategies for remaining competitive and profitable in the long run.



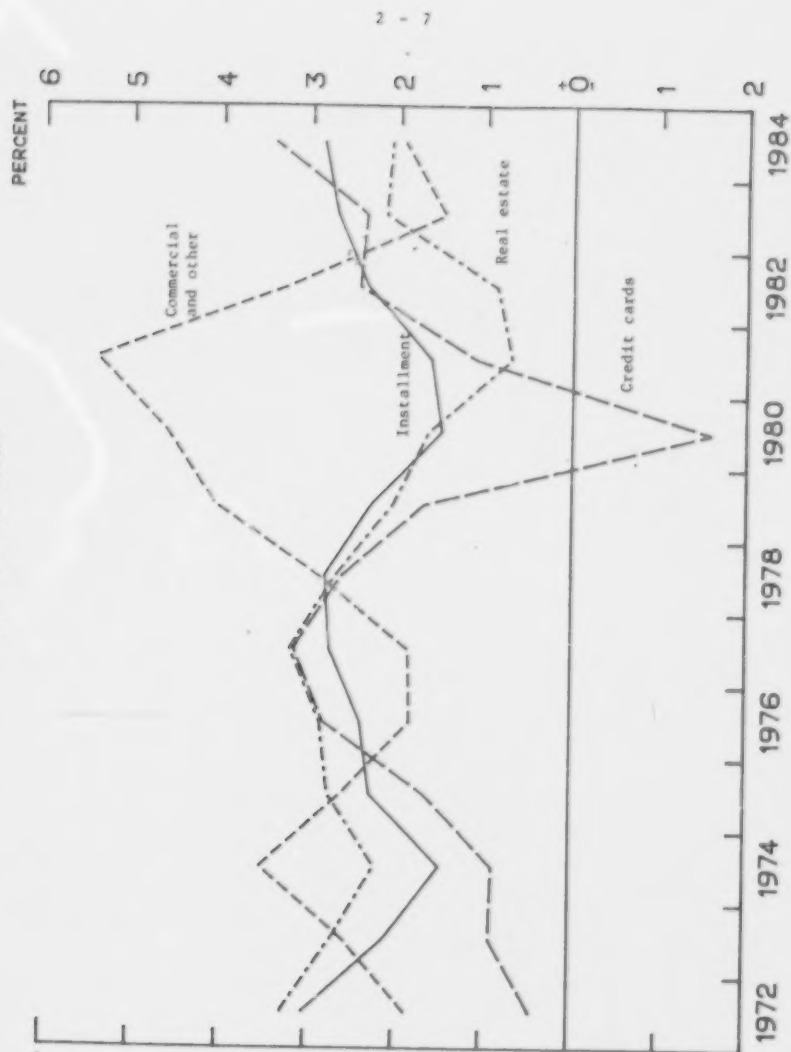
Table 2.2

NET EARNINGS BEFORE TAXES AS A SHARE OF CREDIT  
OUTSTANDING FOR MAJOR TYPES OF COMMERCIAL BANK LENDING(Average, 1972-1984, for reporting banks with  
total deposits of \$50 million or more)

| Type of lending            | Net earnings after the cost of money<br>but before taxes as a percent of<br>credit outstanding |
|----------------------------|------------------------------------------------------------------------------------------------|
| Credit card plans          | 1.68                                                                                           |
| Real estate mortgage loans | 2.24                                                                                           |
| Installment loans          | 2.32                                                                                           |
| Commercial and other loans | 2.91                                                                                           |

SOURCE: Federal Reserve System, Functional Cost Analysis, annual issues  
1972-1984.

Chart 2.3  
NET EARNINGS BEFORE TAXES AS A SHARE OF  
CREDIT OUTSTANDING FOR MAJOR TYPES OF  
COMMERCIAL BANK LENDING



1984 was the only year in which bank credit card plans were more profitable than the other major types of commercial bank lending surveyed. Because the 1984 level of bank credit card profitability was unusually high by historic standards, it seems questionable to use this figure as a basis for evaluating the likely effects of new rate regulation policies. Accordingly, the 13-year average, which includes industry experience under unfavorable as well as favorable economic conditions, seems to provide a more reliable indicator of bank credit card profitability.

#### Retail Credit Card Profitability

By contrast to the low but positive profitability of bank credit cards, revolving credit plans at retail firms, on average, appear to have operated at a loss.<sup>1/</sup> Estimates based on data from a national survey of retail business conducted for the National Retail Merchants Association in 1968 indicated that, on average, losses on retailer credit card plans amounted to more than 4 percent of credit outstanding.<sup>2/</sup> A study of retailers located in New York State, carried out in 1973, showed a 7 percent loss as a percentage of credit outstanding for retail revolving credit plans.<sup>3/</sup> Tighter credit card

<sup>1/</sup> Depending on the types of merchandise sold and on competitive conditions, retailers may be able to offset some of the costs of providing credit card services by raising merchandise prices or by increasing sales volume.

<sup>2/</sup> National Retail Merchants Association, "Economic Characteristics of Department Store Credit" (1969), p. 53. A similar study by NRMA of retailer credit operations in fiscal year 1984 is now under way, but final results are not yet available.

<sup>3/</sup> Robert P. Shay and William C. Dunkelberg, "Retail Store Credit Card Use in New York," *Studies in Consumer Credit*, no. 4, Graduate School of Business, Columbia University (1975), pp. 72-80.

rate ceilings would tend to exacerbate retailer losses, because there is no margin of profit on credit card operations to help absorb any reduction in revenues from credit card plans.

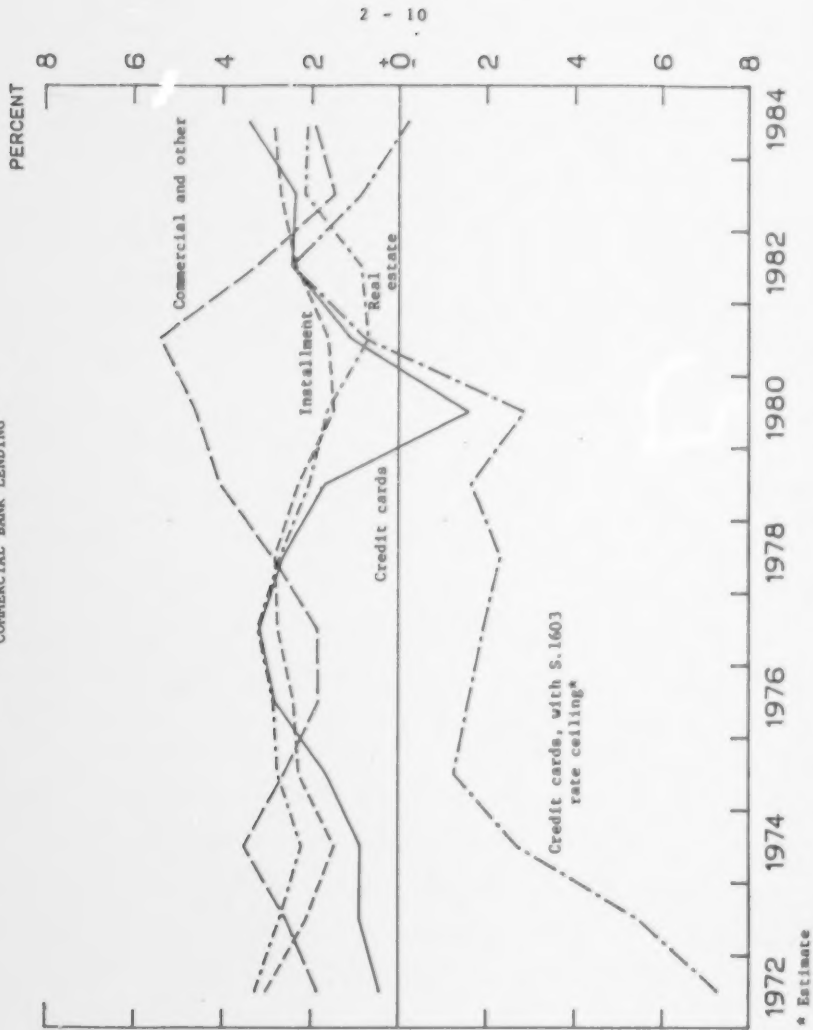
#### Implications for Adjustments by Credit Card Issuers

The evidence suggests that before-tax profits on bank credit card plans typically have been low both in absolute terms and relative to other commercial bank lending activities. Indeed, it seems that overall bank profits would have been larger if banks had re-allocated funds from credit card plans to other bank lending functions. Retail revolving credit plans appear to have operated at a loss. Therefore, contrary to common impressions, it seems unlikely that credit card issuers could absorb the effects of significantly tighter controls on credit card rates merely by accepting lower profits. Instead, adjustments that would help to curtail costs and to increase revenues are likely to be undertaken if more stringent rate ceilings were implemented.

#### Scope of Adjustments Likely to be Associated with Proposed Rate Ceilings

Estimates based on the Functional Cost Analysis data for commercial banks help indicate the degree to which bank credit card profits might be reduced if new rate ceilings were to be implemented as proposed. The lower line in chart 2.4 shows an estimate of net earnings before taxes on bank credit card plans as a percentage of credit outstanding, assuming that a nationwide rate ceiling had been in effect, based on the formula proposed in S.1603. The other lines on the chart reflect the actual profit experience of major types of commercial bank lending, as previously shown in chart 2.3. Chart 2.5 presents analogous information, based on the rate ceiling formula suggested in S.1922.

Chart 2.4  
NET EARNINGS BEFORE TAXES AS A SHARE OF  
CREDIT OUTSTANDING FOR MAJOR TYPES OF  
COMMERCIAL BANK LENDING



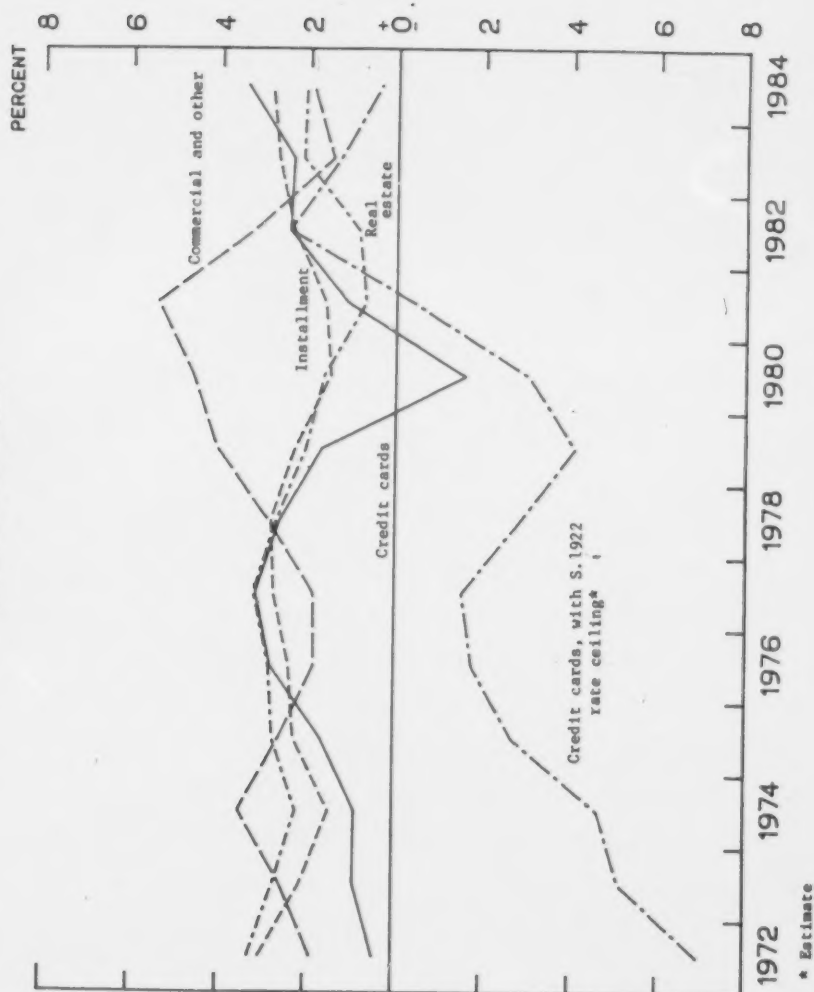
The estimates were derived by assuming that lenders would have continued to provide, and that credit card users would have used, exactly the same dollar amounts of credit card services even though the lower rate ceilings were in effect. Thus, the estimated differences in credit card profits reflect only the changes in gross finance charge revenues that would have resulted from the lower finance rates.

Of course, if forced to operate in a more restrictive rate environment, bank credit card issuers undoubtedly would take steps to boost revenues and to cut costs. But, the purpose of these estimates is to show how much the rate regulations would reduce profits, in the absence of any other changes, in order to gauge the pressures that bank credit card issuers would feel to make offsetting adjustments.

According to these estimates, if the rate ceilings called for in either S.1603 or S.1922 had been in effect from 1974 through 1984, bank credit card plans would have experienced a loss in 10 of the 13 years from 1972 through 1984, and only marginal profits in two years. On average, estimated net earnings before taxes would have been approximately -1.79 percent for S.1603 and -2.23 percent for S.1922. These estimates suggest that the pressures to make cost and revenue adjustments could be quite intense, if rate ceilings such as those proposed were enacted.



Chart 2.5  
NET EARNINGS BEFORE TAXES AS A SHARE OF  
CREDIT OUTSTANDING FOR MAJOR TYPES OF  
COMMERCIAL BANK LENDING



## Chapter 3

## CREDIT CARD HOLDING AND USE

The impact on consumers of imposing a national credit card rate ceiling can be more clearly evaluated by studying recent patterns in the holding and use of credit cards by consumers. Since World War II, credit card holding has expanded rapidly to the point that it is commonplace among U.S. families. This growth appears to reflect both an expanding demand for credit card services and a substantial increase in the number of credit card suppliers. It also stems from a greater willingness of many card issuers to supply cards to a broader range of credit risks than in previous years, when some kinds of cards were marketed mainly to the more affluent.

Two main types of credit card services are available to consumers in today's marketplace. One type, known as the "two-party card", involves a direct agreement between a consumer and a creditor—for example, a general merchandise retailer or a gasoline company. Another kind of credit card is the "third-party card"—such as a bank credit card or a travel and entertainment card—that features an arrangement between a card issuer, a firm that accepts payment by that credit card, and a consumer.

Many credit card plans offer card holders the option of paying off their credit card balances over a span of several months. Such arrangements are referred to as revolving credit. Other credit cards are 30-day credit plans, with full repayment expected within a short period after a monthly bill is received.

Credit Card Holding

Information on consumer holding and use of credit cards is available from a series of surveys of consumer finances conducted during the past two

decades by the Survey Research Center of the University of Michigan. Information from the 1983 Survey of Consumer Finances, for example, indicates that 64 percent of all U.S. families held at least one type of credit card in 1983 (table 3.1). In that year, retail store credit cards were the most widely held type of card, with 57 percent of all families holding at least one of them. Bank credit cards and gasoline credit cards were the next most frequently held, with 42 percent and 28 percent, respectively, of all families holding at least one such card. The types of credit cards least frequently held in 1983 were travel and entertainment cards and other cards--primarily airline and car rental cards.

Overall, credit card holding among all families remained roughly unchanged between 1977 (63 percent of all families) and 1983 (64 percent). However, significant changes in the types of credit cards held by families did occur during this period of time. For instance, the proportion of families holding gasoline credit cards declined markedly, from 34 percent of all families in 1977 to 28 percent in 1983. In contrast, bank credit card holding rose from 38 percent to 42 percent of all families. Meanwhile, the share of families holding retail credit cards increased from 54 percent in 1977 to 57 percent in 1983. The slight expansion in retail card holding reflected some underlying changes in the types of retail cards held. Between 1978 and 1983, the proportion of families holding local store cards jumped from 24 percent to 37 percent, while holding of national chain store cards rose slowly from 45 percent to 48 percent.

In addition to presenting information about credit card holding, table 3.1 reports how frequently credit cards of different types were used, as of 1983. Relatively few families reported never using the credit cards

Table 3.1

## HOLDING AND USE OF CREDIT CARDS, SELECTED YEARS

| Type of card                       | Have card <sup>1</sup> |      |      | Frequency of card use in 1983 <sup>2</sup> |             |            |       |
|------------------------------------|------------------------|------|------|--------------------------------------------|-------------|------------|-------|
|                                    | 1977                   | 1978 | 1983 | Never                                      | Hardly ever | Some-times | Often |
| Any                                | 63                     | 64   | 64   | --                                         | --          | --         | --    |
| Bank <sup>3</sup>                  | 38                     | 41   | 42   | 4                                          | 28          | 39         | 28    |
| Gasoline                           | 34                     | 35   | 28   | 8                                          | 32          | 20         | 40    |
| Travel and entertainment           | 9                      | 11   | 10   | 6                                          | 28          | 36         | 31    |
| Retail store                       | 54                     | n.a. | 57   | --                                         | --          | --         | --    |
| National chain retail <sup>4</sup> | n.a.                   | 45   | 48   | 7                                          | 41          | 39         | 12    |
| Other retail <sup>5</sup>          | n.a.                   | 24   | 37   | 8                                          | 36          | 41         | 14    |
| Other <sup>6</sup>                 | 7                      | 7    | 5    | 30                                         | 39          | 20         | 10    |

1/ Percent based on all families.

2/ Percent based on holders of specified type of credit card.

3/ Bank card category includes Mastercard, Visa, as well as other similar general purpose cards, such as the Choice card, that are issued through banks.

4/ National chain retail category includes Sears Roebuck & Co., J.C. Penney, and Montgomery Ward.

5/ "Other retail" includes local store cards.

6/ "Other" credit cards include car rental, airline, and other miscellaneous credit cards.

n.a.--not available

SOURCE: Thomas A. Durkin and Gregory E. Elliehausen, 1977 Consumer Credit Survey, Washington, D.C.: Board of Governors of the Federal Reserve System, 1978; computations based on data from the Survey of Consumer Attitudes (August and November 1978), Survey Research Center, University of Michigan; and Robert B. Avery and others, 1983 Survey of Consumer Finances, Washington, D.C.: Board of Governors of the Federal Reserve System, forthcoming.

that they held, as would be expected since consumers ordinarily would not go to the trouble of obtaining a credit card without intending to use it at least occasionally. However, from 30 to 40 percent of credit cards reportedly are used infrequently.

#### Characteristics of Credit Card Users

The demographic and financial characteristics of credit card users, by type of card, are profiled in tables 3.2 and 3.3.<sup>1/</sup> The tables reveal significant differences in the level of credit card usage among various subgroups of families.<sup>2/</sup> Overall, as shown in table 3.2, the 1983 survey found that 62 percent of all families reported using credit cards. This proportion was up significantly from 1970 when 50 percent of respondents were card users.

Irrespective of the type of credit card, usage rises sharply and continuously with either family income, measured in constant dollars, or the educational attainment of the head of the family. In 1983, credit cards were used by 95 percent of families in the highest income category and by 90 percent of those whose head was a college graduate. In contrast, only 18 percent of families with incomes below \$5,000 and only 37 percent of those whose head had not received a high school diploma used credit cards in 1983.

Successive consumer surveys have found that substantial proportions of families whose head is between the ages of 25 and 64 years are card users. On the other hand, the proportion of families using credit cards is significantly lower than average for families headed by individuals younger than 25 years

<sup>1/</sup> For each type of credit card, card users are defined as all card holders minus those card holders who report they never use their credit cards.

<sup>2/</sup> The proportion of families with particular characteristics that reports using credit cards reflects the availability of credit card accounts to such families as well as their propensity to use the credit cards they hold.

Table 3.2

PROPORTION OF FAMILIES WITH SELECTED CHARACTERISTICS THAT USED  
SPECIFIED TYPES OF CREDIT CARDS, VARIOUS YEARS, 1970-1983<sup>1</sup>

| Family characteristic                           | Any credit cards |      |      | Bank cards |      |      | Gasoline cards |      |      |
|-------------------------------------------------|------------------|------|------|------------|------|------|----------------|------|------|
|                                                 | 1970             | 1977 | 1983 | 1970       | 1977 | 1983 | 1970           | 1977 | 1983 |
| All families                                    | 50               | 60   | 62   | 16         | 35   | 40   | 34             | 32   | 26   |
| <u>Education of family head</u>                 |                  |      |      |            |      |      |                |      |      |
| 0 - 8 grades                                    | 25               | 30   | 30   | 5          | 13   | 14   | 14             | 12   | 8    |
| 9 - 11 grades                                   | 40               | 45   | 46   | 10         | 21   | 23   | 23             | 18   | 16   |
| High school diploma                             | 58               | 62   | 62   | 18         | 32   | 36   | 36             | 29   | 19   |
| Some college                                    | 59               | 70   | 71   | 20         | 41   | 48   | 42             | 37   | 30   |
| College degree                                  | 82               | 89   | 90   | 34         | 69   | 70   | 68             | 63   | 53   |
| <u>Age of family head (years)</u>               |                  |      |      |            |      |      |                |      |      |
| Under 25                                        | 42               | 39   | 38   | 12         | 16   | 20   | 23             | 12   | 8    |
| 25 - 34                                         | 61               | 65   | 61   | 20         | 40   | 37   | 41             | 31   | 20   |
| 35 - 44                                         | 57               | 72   | 73   | 23         | 49   | 52   | 39             | 42   | 30   |
| 45 - 54                                         | 60               | 68   | 69   | 19         | 40   | 45   | 39             | 39   | 30   |
| 55 - 64                                         | 46               | 61   | 72   | 12         | 36   | 50   | 34             | 34   | 37   |
| 65 - 74                                         | 37               | 49   | 60   | 7          | 20   | 37   | 25             | 27   | 26   |
| 75 and over                                     | 20               | 34   | 35   | 3          | 11   | 16   | 10             | 16   | 15   |
| <u>Family income</u><br>(constant 1983 dollars) |                  |      |      |            |      |      |                |      |      |
| Less than 5,000                                 | 15               | 21   | 18   | 2          | 8    | 4    | 7              | 9    | 3    |
| 5,000 - 7,499                                   | 19               | 24   | 29   | 3          | 4    | 12   | 9              | 8    | 6    |
| 7,500 - 9,999                                   | 19               | 27   | 33   | 2          | 7    | 19   | 11             | 11   | 14   |
| 10,000 - 14,999                                 | 31               | 41   | 49   | 7          | 15   | 26   | 18             | 16   | 16   |
| 15,000 - 19,999                                 | 46               | 56   | 64   | 12         | 26   | 36   | 28             | 24   | 19   |
| 20,000 - 24,999                                 | 56               | 66   | 71   | 15         | 31   | 40   | 33             | 30   | 22   |
| 25,000 - 29,999                                 | 62               | 72   | 78   | 21         | 41   | 49   | 42             | 32   | 31   |
| 30,000 - 39,999                                 | 72               | 78   | 87   | 25         | 53   | 65   | 50             | 41   | 40   |
| 40,000 - 49,999                                 | 76               | 87   | 88   | 31         | 58   | 70   | 57             | 54   | 43   |
| 50,000 or more                                  | 82               | 91   | 95   | 38         | 73   | 80   | 68             | 67   | 61   |
| <u>Occupation of family head</u>                |                  |      |      |            |      |      |                |      |      |
| Professional or technical                       | n.a.             | 84   | 83   | 31         | 59   | 62   | n.a.           | 56   | 43   |
| Managers                                        | n.a.             | 86   | 86   | 30         | 63   | 67   | n.a.           | 54   | 44   |
| Self-employed managers                          | n.a.             | 69   | 75   | 16         | 45   | 49   | n.a.           | 48   | 40   |
| Clerical or sales                               | n.a.             | 69   | 73   | 21         | 39   | 49   | n.a.           | 34   | 30   |
| Craftsmen or foremen                            | n.a.             | 61   | 64   | 22         | 34   | 37   | n.a.           | 29   | 23   |
| Operatives, laborers, or<br>service workers     | n.a.             | 43   | 45   | 10-11      | 18   | 24   | n.a.           | 16   | 12   |
| Farmers or farm managers                        | n.a.             | 33   | 37   | 7          | 16   | 27   | n.a.           | 18   | 18   |
| Miscellaneous                                   | n.a.             | 37   | 31   | 5-9        | 14   | 17   | n.a.           | 17   | 13   |



Table 3.2 (cont'd)

| Family characteristic                    | Travel and entertainment cards |      |      | Any retail cards |      |      | National chain retail <sup>2</sup> |      | Other retail |      | "Other" cards <sup>3</sup> |      |
|------------------------------------------|--------------------------------|------|------|------------------|------|------|------------------------------------|------|--------------|------|----------------------------|------|
|                                          | 1970                           | 1977 | 1983 | 1977             | 1978 | 1983 | 1978                               | 1983 | 1978         | 1983 | 1977                       | 1983 |
| All families                             | 9                              | 7    | 9    | 50               | 48   | 54   | 41                                 | 44   | 22           | 34   | 4                          | 4    |
| Education of family head                 |                                |      |      |                  |      |      |                                    |      |              |      |                            |      |
| 0 - 8 grades                             | 3                              | 1    | 1    | 24               | 16   | 25   | 11                                 | 21   | 8            | 12   | 1                          | *    |
| 9 - 11 grades                            | 4                              | 2    | 2    | 39               | 29   | 38   | 25                                 | 29   | 14           | 21   | 1                          | 1    |
| High school diploma                      | 9                              | 4    | 4    | 52               | 50   | 55   | 43                                 | 46   | 20           | 30   | 4                          | 2    |
| Some college                             | 15                             | 12   | 11   | 59               | 60   | 62   | 52                                 | 52   | 32           | 40   | 4                          | 6    |
| College degrees                          | 22                             | 21   | 27   | 73               | 71   | 77   | 61                                 | 60   | 35           | 59   | 11                         | 9    |
| Age of family head (years)               |                                |      |      |                  |      |      |                                    |      |              |      |                            |      |
| Under 25                                 | 5                              | 2    | 7    | 29               | 45   | 32   | 38                                 | 20   | 25           | 20   | 1                          | 2    |
| 25 - 34                                  | 10                             | 7    | 10   | 53               | 52   | 52   | 46                                 | 42   | 17           | 30   | 4                          | 4    |
| 35 - 44                                  | 11                             | 12   | 13   | 63               | 57   | 63   | 52                                 | 54   | 24           | 39   | 6                          | 5    |
| 45 - 54                                  | 12                             | 12   | 10   | 56               | 56   | 61   | 48                                 | 52   | 30           | 39   | 6                          | 5    |
| 55 - 64                                  | 10                             | 6    | 11   | 52               | 44   | 62   | 40                                 | 51   | 19           | 40   | 6                          | 5    |
| 65 - 74                                  | 6                              | 3    | 5    | 39               | 38   | 53   | 27                                 | 41   | 22           | 37   | 3                          | 2    |
| 75 and over                              | 3                              | 4    | *    | 25               | 32   | 26   | 21                                 | 21   | 22           | 18   | 2                          | 1    |
| Family income<br>(constant 1983 dollars) |                                |      |      |                  |      |      |                                    |      |              |      |                            |      |
| Less than 5,000                          | 1                              | *    | *    | 15               | 21   | 14   | 13                                 | 10   | 12           | 6    | *                          | *    |
| 5,000 - 7,499                            | 3                              | *    | 2    | 19               | 21   | 25   | 13                                 | 18   | 12           | 16   | 2                          | 2    |
| 7,500 - 9,999                            | 2                              | 1    | 2    | 22               | 32   | 26   | 25                                 | 19   | 13           | 16   | *                          | *    |
| 10,000 - 14,999                          | 4                              | 1    | 2    | 31               | 33   | 40   | 27                                 | 31   | 13           | 23   | *                          | *    |
| 15,000 - 19,999                          | 8                              | 2    | 5    | 47               | 39   | 55   | 35                                 | 44   | 18           | 33   | 2                          | 3    |
| 20,000 - 24,999                          | 7                              | 2    | 6    | 53               | 42   | 62   | 39                                 | 50   | 19           | 33   | 2                          | 2    |
| 25,000 - 29,999                          | 12                             | 3    | 10   | 59               | 55   | 67   | 51                                 | 56   | 19           | 41   | 2                          | 3    |
| 30,000 - 39,999                          | 10                             | 10   | 13   | 68               | 67   | 76   | 57                                 | 64   | 30           | 44   | 6                          | 6    |
| 40,000 - 49,999                          | 13                             | 12   | 14   | 76               | 74   | 81   | 64                                 | 72   | 41           | 58   | 6                          | 6    |
| 50,000 or more                           | 34                             | 31   | 17   | 79               |      | 85   |                                    | 68   |              | 68   | 16                         | 14   |
| Occupation of family head                |                                |      |      |                  |      |      |                                    |      |              |      |                            |      |
| Professional or technical                | n.a.                           | 14   | 19   | 72               | 77   | 69   | 65                                 | 56   | 35           | 47   | 9                          | 7    |
| Managers                                 | n.a.                           | 22   | 25   | 67               | 62   | 77   | 53                                 | 64   | 38           | 54   | 12                         | 6    |
| Self-employed managers                   | n.a.                           | 19   | 19   | 51               | 39   | 64   | 39                                 | 49   | 21           | 44   | 7                          | 9    |
| Clerical or sales                        | n.a.                           | 7    | 11   | 59               | 59   | 65   | 51                                 | 54   | 34           | 44   | 4                          | 4    |
| Craftsmen or foremen                     | n.a.                           | 3    | 4    | 51               | 35   | 55   | 34                                 | 47   | 10           | 31   | 3                          | 3    |
| Operatives, laborers, or service workers | n.a.                           | 1    | 1    | 42               | 34   | 38   | 31                                 | 31   | 10           | 21   | 1                          | 2    |
| Farmers or farm managers                 | n.a.                           | 4    | 1    | 24               | 18   | 29   | 18                                 | 26   | 2            | 11   | *                          | 1    |
| Miscellaneous                            | n.a.                           | *    | 4    | 29               | 45   | 30   | 35                                 | 19   | 23           | 21   | 2                          | 2    |

\* Less than 0.5 percent.

1/ Excludes a few cases where use was not ascertained.

2/ National chain retail includes Sears, J.C. Penney, and Montgomery Ward.

3/ "Other" cards include airline and automobile rental cards, and other miscellaneous credit cards.

SOURCE: George Katona and others, 1970 Survey of Consumer Finances, Ann Arbor, Michigan: Survey Research Center, The University of Michigan, 1971; Thomas A. Durkin and Gregory E. Elliehausen, 1977 Consumer Credit Survey, Washington, D.C.: Board of Governors of the Federal Reserve System, 1978; and Robert B. Avery and others, 1983 Survey of Consumer Finances, Washington, D.C.: Board of Governors of the Federal Reserve System, forthcoming.

of age or older than 64 years. These results probably reflect the fact that younger families are less likely to have established an acceptable credit rating and to have acquired credit cards, whereas the purchasing habits or available liquid assets of families headed by older individuals may reduce their need for credit card services. Very high proportions of credit card use are found among families headed by individuals with professional, technical, and managerial occupations.

As shown in table 3.2, bank credit card use increased from just 16 percent of all families in 1970 to 40 percent in 1983. Bank credit card use rose substantially for every family income, age, education and occupation category. In 1970, for example, only 38 percent of families with incomes above \$50,000, in constant 1983 dollars, used bank credit cards. By 1983, 80 percent of such families used bank cards. The growth in bank card holding and use among families may reflect to some extent a substitution of revolving debt for closed-end installment credit. It may also reflect a substitution of bank credit cards for gasoline and store credit cards as gas companies and some retailers either abandoned their own card programs or began to accept both proprietary and bank cards.

Retail store credit cards are used by more families than any other type of credit card. In every family category presented in table 3.2, a higher proportion of families own and use store cards as compared with bank cards. In particular, store card use is significantly more widespread than bank card use among lower income families, families headed by persons under 35 years of age, and families with less well-educated heads. Even so, less than 25 percent of the families with incomes below \$10,000 in 1983 used retail store credit cards.

Table 3.3 presents information that relates the type of credit cards used by families in 1983 to selected financial and demographic characteristics. It can be seen that substantial proportions of bank credit card owners used national chain store and local store retail credit cards. While only 44 percent of all families used national chain store credit cards in 1983, 71 percent of those with bank cards also used these retail cards. Similarly, although only 34 percent of all families used local store cards in 1983, 57 percent of bank card owners used such cards.

Several additional observations can be made from the data presented in table 3.3. First, those families that used travel and entertainment cards and "other" cards were the most likely groups to use the remaining types of cards as well. Only 9 percent of all families surveyed used travel and entertainment cards, but among those that did, substantially more than half also used bank (81 percent), gasoline (63 percent), national retail (67 percent), and local retail (68 percent) cards. Similar associations were found for users of "other" credit cards.

One factor that seems to be highly correlated with credit card use is the amount of liquid assets held by families. Those with substantial liquid assets--in excess of \$7,500 in 1983--were far more likely to use each type of credit card than were families with lower amounts of liquid assets.

Other data relating to financial characteristics of families also support the notion that higher income, financially more sophisticated families tend to be heavier credit card users. For example, usage of various kinds of credit cards was greater as a proportion of families that had money market mutual funds as compared with families that used more ordinary financial services such as checking accounts. Furthermore, 50 percent of homeowners used bank cards, while only 27 percent of renters used such cards.

3-9

Table 3.3

PROPORTION OF FAMILIES WITH SELECTED FINANCIAL AND DEMOGRAPHIC  
CHARACTERISTICS THAT USED SPECIFIED TYPES OF CREDIT CARDS, 1983

| Family characteristic                                                                           | Percent of<br>all families | Type of credit card used |          |                             |                    |                 |       |
|-------------------------------------------------------------------------------------------------|----------------------------|--------------------------|----------|-----------------------------|--------------------|-----------------|-------|
|                                                                                                 |                            | Bank                     | Gasoline | Travel and<br>entertainment | National<br>retail | Local<br>retail | Other |
| <u>Type of credit card used</u>                                                                 |                            |                          |          |                             |                    |                 |       |
| Bank                                                                                            | 40                         | 100                      | 49       | 17                          | 71                 | 57              | 6     |
| Gasoline                                                                                        | 26                         | 77                       | 100      | 22                          | 77                 | 60              | 8     |
| Travel and entertainment                                                                        | 9                          | 81                       | 63       | 100                         | 67                 | 68              | 15    |
| National retail                                                                                 | 44                         | 65                       | 44       | 13                          | 100                | 55              | 5     |
| Local retail                                                                                    | 34                         | 68                       | 45       | 17                          | 72                 | 100             | 7     |
| Other                                                                                           | 4                          | 75                       | 58       | 38                          | 70                 | 71              | 100   |
| <u>Liquid asset holdings<sup>1</sup></u><br>(dollars)                                           |                            |                          |          |                             |                    |                 |       |
| Less than 7,500                                                                                 | 70                         | 33                       | 18       | 6                           | 38                 | 26              | 2     |
| 7,500 - 14,999                                                                                  | 10                         | 59                       | 44       | 16                          | 63                 | 52              | 7     |
| 15,000 or more                                                                                  | 20                         | 61                       | 46       | 20                          | 57                 | 54              | 7     |
| <u>Use of other financial services</u>                                                          |                            |                          |          |                             |                    |                 |       |
| Has checking account                                                                            | 79                         | 48                       | 31       | 10                          | 52                 | 40              | 4     |
| Has money market deposit<br>account                                                             | 8                          | 64                       | 42       | 14                          | 59                 | 53              | 7     |
| Has money market mutual fund                                                                    | 6                          | 75                       | 56       | 24                          | 66                 | 63              | 8     |
| Has brokerage account                                                                           | 7                          | 79                       | 58       | 26                          | 66                 | 69              | 12    |
| Has nonliquid financial assets                                                                  | 23                         | 65                       | 44       | 17                          | 60                 | 55              | 7     |
| Obtains professional advice on<br>what kinds of savings and<br>investments to make <sup>2</sup> | 26                         | 49                       | 34       | 13                          | 51                 | 42              | 7     |
| Has IRA or Keogh account                                                                        | 17                         | 69                       | 50       | 19                          | 68                 | 58              | 6     |
| <u>Housing Status</u>                                                                           |                            |                          |          |                             |                    |                 |       |
| Homeowner                                                                                       | 60                         | 50                       | 32       | 11                          | 56                 | 41              | 4     |
| Renter                                                                                          | 32                         | 27                       | 16       | 7                           | 26                 | 25              | 3     |
| Mobile home                                                                                     | 6                          | 25                       | 12       | e                           | 31                 | 16              | e     |

Table 3.3 (cont'd)

| Family characteristic                      | Percent of all families | Type of credit card used |          |                          |                 |              |       |
|--------------------------------------------|-------------------------|--------------------------|----------|--------------------------|-----------------|--------------|-------|
|                                            |                         | Bank                     | Gasoline | Travel and entertainment | National retail | Local retail | Other |
| <u>Sources of outstanding credit</u>       |                         |                          |          |                          |                 |              |       |
| Commercial bank                            | 19                      | 53                       | 32       | 14                       | 57              | 40           | 5     |
| Savings and loan or savings bank           | 3                       | 64                       | 41       | 20                       | 71              | 55           | 8     |
| Credit union                               | 7                       | 59                       | 36       | 12                       | 64              | 46           | 3     |
| Finance company                            | 12                      | 44                       | 24       | 9                        | 52              | 36           | 3     |
| Store                                      | 7                       | 36                       | 19       | 9                        | 43              | 33           | 2     |
| <u>Type of outstanding credit</u>          |                         |                          |          |                          |                 |              |       |
| Have first mortgage debt                   | 37                      | 58                       | 34       | 15                       | 65              | 46           | 5     |
| Have consumer debt                         | 62                      | 47                       | 30       | 11                       | 52              | 38           | 4     |
| <u>Life-cycle stage of family head</u>     |                         |                          |          |                          |                 |              |       |
| Under 45:                                  |                         |                          |          |                          |                 |              |       |
| Unmarried                                  | 19                      | 28                       | 13       | 8                        | 23              | 25           | 3     |
| Married                                    | 31                      | 42                       | 22       | 8                        | 52              | 30           | 4     |
| Over 45:                                   |                         |                          |          |                          |                 |              |       |
| Unmarried                                  | 19                      | 25                       | 16       | 3                        | 30              | 28           | 2     |
| Married                                    | 31                      | 50                       | 37       | 9                        | 54              | 41           | 4     |
| All ages, married with children            | 9                       | 21                       | 11       | 3                        | 28              | 24           | 2     |
| Age 25-40, college educated urban/suburban | 6                       | 67                       | 45       | 26                       | 57              | 56           | 7     |
| All families                               | 100                     | 40                       | 26       | 9                        | 44              | 34           | 4     |

\* Less than 0.5 percent.

1/ Liquid assets include checking accounts, savings accounts, money market accounts, certificates of deposit, IRA or Keogh accounts, and savings bonds.

2/ Obtains advice from accountant, banker, broker, tax adviser, or lawyer.

SOURCE: Robert B. Avery and others, 1983 Survey of Consumer Finances, Washington, D.C.: Board of Governors of the Federal Reserve System, forthcoming.

Consumer Credit Card Repayment Practices

The preceding sections profiled the holding and use patterns of credit cards of all types. To analyze the effects on consumers of proposed finance rate controls on bank and retail store credit cards, additional information is needed about how consumers use the revolving debt features of these cards.

The key characteristic that distinguishes revolving credit plans from closed-end credit is that the repayment terms for revolving credit are flexible and largely at the discretion of the account holder. Excluding cash advances, which typically earn finance charges from the transaction date, most revolving credit card plans charge interest only if the card holder pays less than the full amount of the outstanding balance during the interest-free grace period.<sup>1/</sup> Thus, unlike other kinds of credit, the way the credit card holder uses the account determines how much--and, indeed, whether any--interest income is earned by the card issuer.

Evidence suggests that some credit card holders--perhaps between 4 to 8 percent at any one time--do not use their bank or store credit cards at all (table 3.1). Although they may pay annual fees, these nonusers produce no finance charge revenue to help offset the costs to card issuers of establishing and maintaining their accounts.

Consumer survey data indicate that the remaining credit card holders may be grouped into one of two distinct categories based on their customary repayment practices. "Convenience users" are individuals who use a credit card primarily for the convenience that it affords in conducting transactions; such

<sup>1/</sup> In 1984, about 78 percent of respondent commercial banks allowed a grace period, which averaged approximately 28 days, before a finance charge was assessed. See American Bankers Association, 1985 Retail Bank Credit Report, table 115, p. 87.



users ordinarily pay off their balance during the interest-free grace period and usually avoid incurring finance charges. "Borrowers" are individuals who typically do not pay off their credit card balance in full during the interest-free period, and therefore often incur finance charges.

Contrasting credit card usage patterns among consumers reflect the different factors that motivate them to use credit cards. Individuals using credit cards for transaction convenience may do so for a variety of reasons. Card holders may be able to maintain smaller average cash balances or to replenish depleted cash balances less frequently, since credit card purchases made during a month are not paid for until a bill is received. Also, in some circumstances--for example, when travelling--credit cards often are more convenient because personal checks are difficult to use or are not accepted. Credit cards also are advantageous in situations where a receipt as proof of purchase is needed to obtain reimbursement for expenses. Furthermore, a consumer often has greater leverage in seeking to resolve a dispute about the return of merchandise if the purchase were made with a credit card.

Apart from the convenience that credit cards can afford in making purchases, use of a credit card provides short-term credit during the period between the purchase of merchandise or services and payment of the credit card balance. Some credit cards also permit borrowing for an extended period of time. The revolving credit feature available with many credit cards offers an alternative to closed-end credit such as personal loans and installment sales contracts. The primary advantage of revolving credit is that--within the credit limit--the card holder can increase or reduce the amount borrowed at any time, rather than applying for a new loan each time a need for credit arises, and then adhering to a rigid repayment schedule. Credit cards with revolving credit

features offer a high degree of repayment flexibility because minimum monthly payment requirements are low--often as little as 5 to 10 percent of the total amount owed.

On occasion, card users deviate from their typical usage patterns. A convenience user may choose to repay a particularly large purchase in installments; a borrower may sometimes repay the outstanding balance completely. Nevertheless, consumers can be characterized as convenience users or borrowers according to their customary repayment habits.

Consumer responses to questions about their repayment practices have been remarkably consistent over time. In consumer surveys conducted in 1977 and 1983, about half of the respondents stated that they nearly always paid their bank and retail store credit card bills in full each month (table 3.4). These consumers appear to be essentially convenience users. The remaining families were about evenly divided in both 1977 and 1983 between those that sometimes paid their bills in full each month, and those that hardly ever repaid their entire outstanding balance by the end of the billing cycle.<sup>1/</sup>

Customary credit card bill repayment patterns are not uniform among all groups of consumers (table 3.4). For example, the proportion of consumers stating that they nearly always repaid their credit card bills in full rises sharply with increases in the age of the head of household. In 1983, only 39 percent of families whose head was under 25 years of age customarily paid off their credit card bills in full each month, but nearly 76 percent of families headed by persons of 65 years of age and over did so. However, a substantial

<sup>1/</sup> The survey question asked, "When you use bank cards or store cards, do you almost always pay the total amount due each month to avoid a finance charge, do you sometimes do this, or do you hardly ever pay it in full and have to pay a finance charge?"

Table 3.4

PERCENT DISTRIBUTION OF REPAYMENT PRACTICES FOR FAMILIES THAT USE BANK OR STORE CREDIT CARDS, 1977 AND 1983, BY SELECTED FAMILY CHARACTERISTICS

| Family characteristic                       | Nearly<br>always pay<br>in full |      | Sometimes<br>pay in full |      | Hardly ever<br>pay in full |      |
|---------------------------------------------|---------------------------------|------|--------------------------|------|----------------------------|------|
|                                             | 1977                            | 1983 | 1977                     | 1983 | 1977                       | 1983 |
| All bank or store card users                | 49                              | 47   | 28                       | 26   | 23                         | 27   |
| <u>Family income<sup>2</sup> (dollars)</u>  |                                 |      |                          |      |                            |      |
| Less than 5,000                             | 54                              | 43   | 28                       | 19   | 18                         | 38   |
| 5,000 - 7,499                               | 52                              | 49   | 18                       | 25   | 30                         | 27   |
| 7,500 - 9,999                               | 45                              | 51   | 29                       | 27   | 27                         | 22   |
| 10,000 - 14,999                             | 44                              | 48   | 31                       | 23   | 26                         | 28   |
| 15,000 - 19,999                             | 41                              | 43   | 31                       | 27   | 28                         | 31   |
| 20,000 - 24,999                             | 42                              | 41   | 31                       | 28   | 27                         | 31   |
| 25,000 - 29,999                             | 55                              | 45   | 27                       | 23   | 18                         | 32   |
| 30,000 - 39,999                             | 56                              | 46   | 26                       | 29   | 18                         | 25   |
| 40,000 - 49,999                             | 61                              | 43   | 25                       | 31   | 13                         | 26   |
| 50,000 and more                             | 78                              | 60   | 16                       | 24   | 6                          | 16   |
| <u>Age of family head (years)</u>           |                                 |      |                          |      |                            |      |
| Under 25                                    | 38                              | 39   | 33                       | 28   | 29                         | 33   |
| 25 - 34                                     | 43                              | 37   | 33                       | 29   | 25                         | 34   |
| 35 - 44                                     | 41                              | 35   | 31                       | 33   | 27                         | 32   |
| 45 - 54                                     | 47                              | 46   | 29                       | 27   | 24                         | 27   |
| 55 - 64                                     | 60                              | 54   | 24                       | 24   | 16                         | 21   |
| 65 - 74                                     | 77                              | 76   | 13                       | 12   | 10                         | 12   |
| 75 and over                                 | 85                              | 76   | 15                       | 12   | *                          | 12   |
| <u>Education of family head</u>             |                                 |      |                          |      |                            |      |
| 0 - 8 grades                                | 57                              | 49   | 19                       | 18   | 24                         | 32   |
| 9 - 11 grades                               | 46                              | 47   | 27                       | 25   | 27                         | 27   |
| High school diploma                         | 46                              | 46   | 28                       | 26   | 26                         | 28   |
| Some college                                | 47                              | 41   | 31                       | 29   | 21                         | 29   |
| College degree                              | 58                              | 52   | 29                       | 26   | 13                         | 21   |
| <u>Occupation of family head</u>            |                                 |      |                          |      |                            |      |
| Professional, technical                     | 57                              | 50   | 30                       | 27   | 13                         | 23   |
| Managers                                    | 53                              | 50   | 32                       | 28   | 15                         | 21   |
| Self-employed managers                      | 65                              | 60   | 16                       | 24   | 19                         | 16   |
| Clerical or sales                           | 48                              | 44   | 30                       | 26   | 21                         | 30   |
| Craftsmen or foremen                        | 46                              | 44   | 28                       | 29   | 26                         | 28   |
| Operatives, laborers,<br>or service workers | 40                              | 40   | 28                       | 25   | 32                         | 35   |
| Farmers or farm managers                    | 68                              | 74   | 24                       | 12   | 8                          | 14   |
| Miscellaneous                               | 45                              | 56   | 23                       | 22   | 32                         | 23   |

3 - 15

Table 3.4 (cont'd)

| Family characteristic                          | Nearly<br>always pay<br>in full |      | Sometimes<br>pay in full |      | Hardly ever<br>pay in full |      |
|------------------------------------------------|---------------------------------|------|--------------------------|------|----------------------------|------|
|                                                | 1977                            | 1983 | 1977                     | 1983 | 1977                       | 1983 |
| <u>Race or national origin</u>                 |                                 |      |                          |      |                            |      |
| Caucasian                                      | 52                              | 50   | 28                       | 26   | 20                         | 25   |
| Black                                          | 26                              | 29   | 34                       | 27   | 40                         | 45   |
| Hispanic                                       | 38                              | 17   | 27                       | 41   | 35                         | 43   |
| <u>Life-cycle stage of family head</u>         |                                 |      |                          |      |                            |      |
| Under 45 years                                 |                                 |      |                          |      |                            |      |
| Unmarried, no children                         | 49                              | 48   | 30                       | 22   | 22                         | 30   |
| Married, no children                           | 49                              | 32   | 29                       | 32   | 22                         | 36   |
| Married, youngest child<br>under 6 years       | 39                              | 35   | 34                       | 33   | 27                         | 32   |
| Married, youngest child<br>6 years and older   | 40                              | 36   | 32                       | 31   | 28                         | 34   |
| 45 years and older                             |                                 |      |                          |      |                            |      |
| Married, has children                          | 42                              | 47   | 30                       | 26   | 28                         | 27   |
| Married, no children,<br>head retired          | 74                              | 73   | 17                       | 16   | 9                          | 11   |
| Married, no children,<br>head in labor force   | 61                              | 54   | 21                       | 28   | 18                         | 20   |
| Unmarried, no children,<br>head retired        | 77                              | 71   | 16                       | 10   | 7                          | 19   |
| Unmarried, no children,<br>head in labor force | 65                              | 54   | 28                       | 21   | 6                          | 25   |
| Any Age                                        |                                 |      |                          |      |                            |      |
| Unmarried, has children                        | 29                              | 25   | 33                       | 37   | 38                         | 38   |

1/ The 1977 survey included 2,563 families, of whom 1,444 had bank or store cards. The 1983 survey included 3,824 families, of whom 2,087 had bank or store cards.

2/ Calendar year 1982 income.

SOURCE: Thomas A. Durkin and Gregory E. Elliehausen, 1977 Consumer Credit Survey, Washington, D.C.: Board of Governors of the Federal Reserve System, 1978; and Robert B. Avery and others, 1983 Survey of Consumer Finances, Washington, D.C.: Board of Governors of the Federal Reserve System, forthcoming.

share of families in each income and education category reported that they usually paid off their entire outstanding balance in full each month. For example, even within the three lowest income categories, consisting of families with incomes below \$10,000, nearly 48 percent of the families can be categorized as convenience users.<sup>1/</sup>

Customary repayment practices also appear to differ among racial and ethnic groups. In both survey years, a considerably smaller proportion of nonwhite and Hispanic families repaid their credit card bills in full, as compared with white families. Among occupational groups, farm families and self-employed managers were the most likely to repay in full each month, while operatives, laborers and service workers were more likely to carry part of their credit card debt forward to the next month.

Consumer survey data on typical credit card debt repayment practices indicate that substantial proportions of consumers in all family categories are essentially convenience users of credit cards. Such families ordinarily do not incur finance charges. Even for families in the lowest family income categories, a sizable share of those with credit cards regularly pay off their outstanding balances in full each month.

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<sup>1/</sup> Multivariate statistical analysis of the credit card repayment data indicates a small but statistically significant relationship between the level of family income and the probability of a family being a convenience user of credit cards. See Glenn B. Canner and Anthony W. Cynrak, "Determinants of Consumer Credit Card Usage Patterns," (staff working paper, Board of Governors of the Federal Reserve System, Division of Research and Statistics, Financial Structure Section, 1985).

## Chapter 4

POSSIBLE ADJUSTMENTS BY CREDIT CARD ISSUERS  
TO MORE RESTRICTIVE RATE REGULATIONS

The analysis of the profitability of bank and retail credit card plans in chapter 2 suggests that credit card issuers--faced with a nationwide imposition of more restrictive credit card rate ceilings, as proposed in current legislation--would likely cut costs and seek more revenue from alternative sources. This chapter examines the specific actions that card issuers might take to enhance revenues or to cut costs. Also, in view of the evidence presented in chapter 3 about usage patterns, this chapter draws some general conclusions about the customer groups most likely to feel the greatest impact of particular adjustments.

Adjustments in the Availability of Services

Tightening credit standards. Perhaps the most evident cost-cutting step that credit card issuers might take is to tighten credit standards so as to reduce collection costs and charge-offs (table 4.1). Such a change would mainly relate to applicants for new credit card accounts. However, holders of existing accounts could be affected similarly by more stringent enforcement of credit limits, and by an increase in minimum payment requirements, on all accounts.

Changes in the availability of credit card credit obviously have the greatest potential effect on card applicants who meet the current minimum requirements for holding a credit card account--such as income level, employment tenure, duration of residency, and previous credit record--but who would not qualify for credit if such standards were stiffened considerably. Although credit decisions are based on many criteria, lower income persons--including



4 - 2

Table 4.1

PROPORTION OF SPECIFIED CUSTOMER GROUPS AFFECTED BY POSSIBLE RESPONSES OF BANK AND  
RETAIL CREDIT CARD ISSUERS TO MORE RESTRICTIVE CREDIT CARD RATE CEILINGS

| Type of response                                                                               | Customer group affected by specified response <sup>1</sup> |                 |                            |                 |
|------------------------------------------------------------------------------------------------|------------------------------------------------------------|-----------------|----------------------------|-----------------|
|                                                                                                | Bank credit card holders                                   |                 | Retail credit card holders |                 |
|                                                                                                | Convenience users                                          | Borrowers       | Convenience users          | Borrowers       |
| <u>Availability adjustments</u>                                                                |                                                            |                 |                            |                 |
| 1. Tighten credit standards <sup>2</sup>                                                       | Relatively few                                             | Relatively many | Relatively few             | Relatively many |
| 2. Reduce or eliminate services <sup>3</sup>                                                   | Some                                                       | Some            | Some                       | Some            |
| <u>Pricing adjustments<sup>4</sup></u>                                                         |                                                            |                 |                            |                 |
| 1. Reduce or eliminate interest-free grace period                                              | All                                                        | Some            | All                        | Some            |
| 2. Stiffen method for calculating balance on which finance charge is based                     | None                                                       | All             | None                       | All             |
| 3. Increase retail price of merchandise                                                        | n.a.                                                       | n.a.            | All                        | All             |
| 4. Increase merchant discount fee (which may be reflected in higher retail merchandise prices) | All                                                        | All             | n.a.                       | n.a.            |
| 5. Start charging, or increase, an annual fee                                                  | All                                                        | All             | All                        | All             |
| 6. Charge a fee for each transaction                                                           | All                                                        | All             | All                        | All             |
| 7. Charge a penalty fee for exceeding credit limit                                             | Few                                                        | Some            | Few                        | Some            |
| 8. Charge a penalty fee for each late payment                                                  | None                                                       | Some            | None                       | Some            |
| 9. Charge a fee for each cash advance                                                          | Some                                                       | Some            | n.a.                       | n.a.            |
| 10. Charge explicitly for services previously provided without charge <sup>5</sup>             | Some                                                       | Some            | Some                       | Some            |

n.a. not applicable

1/ "Convenience users" are individuals who use credit cards primarily for the convenience they afford in conducting transactions; such users typically pay off their balance during the interest-free grace period and usually avoid incurring finance charges. "Borrowers" are individuals who typically do not pay off their full credit card balance during the interest-free period, and therefore often do pay finance charges.

2/ Tighter credit standards ordinarily would be implemented by raising the minimum score necessary under a credit scoring system to qualify for a credit card or to obtain a higher credit limit. Factors that have positive weights in most credit scoring systems include an applicant's income, assets, duration of residence and employment, and previous credit record.

3/ Financial institutions might curtail ancillary services that some institutions provide free of charge such as rental car discounts and merchandise buying services. Severe losses on credit card operations might cause some financial institutions to eliminate credit card plans in favor of other types of lending. Some retailers might eliminate in-house credit card plans in favor of accepting third-party credit cards.

4/ The ability of card issuers to make some of these adjustments may be constrained by competition or by state law.

5/ Financial institutions and retailers might charge fees for services such as processing credit card applications, replacing lost cards, providing more than one credit card, and sending out each statement. Retailers might begin charging for services that previously had been provided free of charge.

recent job market entrants and those with limited education and skills--are likely to be affected more seriously by tighter credit standards than those with greater resources.

Reducing or eliminating services. Financial institutions might curtail services that some offer as credit card enhancements, such as credit card registration, travel discounts, provision of emergency cash to travelers, and merchandise buying services. In the extreme, some financial institutions might cut back or even eliminate credit card plans and redirect their resources into more profitable lines of business. Retail firms might discontinue in-house credit card plans, with the result that customers would rely instead on third-party credit cards or other sources of financing. Although elimination of credit card operations would be an extreme measure, the experience of the early 1980s showed that some retailers and financial institutions did reduce the availability of credit card services in an effort to stem losses.<sup>1/</sup>

#### Adjustments in the Pricing of Services or Merchandise

Curtailing grace periods. An alternative way of offsetting reduced finance rates is to reprice credit card services (table 4.1). One possible change of this kind would be to shorten or eliminate the interest-free grace period that credit card issuers typically have allowed.<sup>2/</sup>

In 1984, a large majority of commercial banks with assets of more than \$50 million charged interest on unpaid balances only after expiration of

<sup>1/</sup> During 1981, for example, about 5 percent of commercial banks with deposits of \$100 million or less, and 1 to 2 percent of larger banks, discontinued credit card plans. See American Bankers Association, 1982 Retail Bank Credit Report, table 98, p. 74.

<sup>2/</sup> Some state regulations require that a minimum grace period be permitted.

a grace period averaging about 27 days, depending on the size of the bank.<sup>1/</sup> However, from 15 to 23 percent of such banks reportedly charged interest on bank credit cards starting with the day of purchase.<sup>2/</sup> Retail credit card issuers, of course, also might choose to reprice credit card services by changing grace periods.

Reduction or elimination of the grace period would adversely affect all credit card users. Convenience users would be hardest hit by elimination of the grace period, because they would then be unable to avoid paying finance charges. However, borrowers who sometimes make full payment and thus avoid incurring finance charges also would be affected.

If regulations that reduced finance rates resulted in curtailed grace periods, the net benefit to credit card holders at lower income levels would be problematic. As discussed in chapter 3, a substantial proportion of lower income credit card holders are "convenience users." Among card holders with less than \$10,000 in family income, 48 percent reported in the 1983 Survey of Consumer Finances that they customarily paid off their outstanding balances in full each month. An additional 24 percent of lower income families reported sometimes paying their balances in full. Although regulations that reduced finance rates would benefit credit card users who incurred finance charges, these benefits would be offset directly by the additional finance charges that lower income convenience users of credit cards would pay, if credit card issuers cut back grace periods in response to more restrictive credit card rate limits.

<sup>1/</sup> American Bankers Association, 1985 Retail Bank Credit Report, table 115, p. 87.

<sup>2/</sup> Ibid., table 114, p. 86.

4 - 5

Among families that had a head aged 65 years and over, convenience users of credit cards constituted three-fourths of credit card users. Thus, the balance of benefits for the elderly seems likely to be negative if issuers shortened or eliminated grace periods on credit cards in response to tighter credit card rate ceilings.

A similar way that card issuers might increase their credit card revenues is to change the method of calculating the balance on which the finance charge is based so that a larger finance charge results. For example, the basis for computing the finance charge could be changed from the end-of-period balance outstanding to the average daily balance outstanding.<sup>1/</sup>

Increasing merchandise prices. A second major type of repricing, available only to retail credit card issuers, is to increase merchandise prices in an attempt to offset all or part of the reduction in finance charge revenue. The feasibility of this response for particular retail firms would depend mainly on their competitive environment. Such price increases, if not undercut by competitive pressures, would affect all retail customers, including approximately 40 percent that pay in cash.<sup>2,3/</sup>

Although increases in merchandise prices can be implemented only by retailers, issuers of third-party credit cards may be able to effect an indirect form of repricing to offset reduced revenue from finance charges.

<sup>1/</sup> State regulations may specify or limit the basis that can be used in computing the finance charge.

<sup>2/</sup> National Retail Merchants Association, "Retail Credit Operating Results, 1983," p. 6.

<sup>3/</sup> Intense competition from cash-only merchants might limit price increases to goods that usually are purchased on credit, so that only customers who pay in cash for such merchandise would subsidize the cost of providing credit services.

Third-party credit card issuers might negotiate an increase in the fees that retail merchants pay card issuers for processing credit card sales tickets--fees usually referred to as the "merchant discount." Since the merchant discount fee is an operating cost to the retailer, any increase in these charges may be passed on in higher prices of merchandise, including prices paid by customers who always pay in cash.

Annual fees and transaction fees. A third major category of repricing actions involves charging other fees of various types.<sup>1/</sup> For example, although seven-tenths or more of medium- to large-sized commercial banks already were charging an annual fee for standard MasterCard and Visa accounts in 1984, these annual fees could be increased to help generate higher revenue, and additional institutions could implement such fees.<sup>2/</sup> Imposing or boosting annual fees would affect all card holders.

A similarly pervasive impact would be felt if a fee for each credit card transaction were charged by card issuers. As of 1984, only about 2 percent of the standard Visa and MasterCard issuers charged such fees.<sup>3/</sup> With the exception of some oil company credit card plans, no retailers are known to be charging annual fees or fees for each transaction. However, apart from legal restrictions on fees that exist in a few states, the main barriers to such a practice appear to be the force of competition and customary practice in the retail industry.

<sup>1/</sup> State laws may limit or prohibit charging certain kinds of fees.

<sup>2/</sup> American Bankers Association, 1985 Retail Bank Credit Report, table 102, p. 80.

<sup>3/</sup> Ibid., table 107, p. 82.

Penalty fees. Some credit card issuers charge a penalty fee when an account balance exceeds the established credit limit or when problems arise such as late payments or returned checks. Late charges were levied in 1984 by about 30 percent of commercial banks that issue standard Visa and MasterCard accounts.<sup>1/</sup> The fee for a late payment averaged between \$4.50 and \$6.50, not including any interest on overdue balances.<sup>2/</sup> Practices of retailers with regard to penalty fees are not well known, but such charges might be used by some retail firms as a means of boosting revenue.

Penalty fees would generally fall on borrowers as opposed to convenience users. The latter group, by definition, typically does not make late payments. Also, convenience users are less likely to exceed established credit limits, since they ordinarily do not carry any balance over from one billing period to the next. Therefore, these adjustments to more stringent rate ceilings would have their greatest impact on borrowers--the group that rate ceilings are intended to benefit.

Service charges. Fees for using particular services, such as cash advances on bank credit cards, might be instituted or raised. Banks and retailers might establish or increase fees for processing credit card applications, replacing lost cards, providing additional cards for an account, and issuing monthly statements. Retailers might begin charging separately for ancillary services that ordinarily have been provided without charge, such as parking, gift wrapping, delivery, and alterations. This type of repricing at least has the advantage that the additional costs are paid by individuals who receive the

<sup>1/</sup> American Bankers Association, 1985 Retail Bank Credit Report, table 107, p. 82.

<sup>2/</sup> Ibid., table 116, p. 87.



services provided. Thus, the incidence of service charges appears likely to affect bank as well as retail credit card holders, and convenience users of credit cards in addition to borrowers.

Unpredictability of Adjustments in Availability and Pricing of Credit Card Services

For several reasons, the adjustments in credit card availability and pricing that would follow imposition of a restrictive nationwide credit card rate ceiling cannot be foreseen with much precision. As discussed earlier, credit card issuers can cut costs and increase revenue in many ways. Card issuers are likely to adopt different policies, depending on how they expect their customers to respond. Furthermore, it seems likely that additional shifts would occur once the responses of card holders to the initial actions became clear.

Adjustments in pricing and credit availability would be subject to important constraints, including competition from other credit card issuers as well as regulations that limit pricing changes in some states. Some credit card issuers already have adapted to fairly stringent rate ceilings at the state level, and might have little additional adjustment to make. Other issuers that operate in less restrictive state regulatory environments likely would find that major changes in credit availability and pricing were necessary.

Retail credit card issuers appear to possess an inherent advantage in adjusting to more stringent rate regulations, because they have some flexibility in setting merchandise prices to compensate for reduced finance charge revenues. Of course, competition with other merchants, as noted, limits the scope of such merchandise price changes. Nevertheless, by comparison, financial institutions have more limited leeway for adapting to the effects of

tighter rate ceilings. As a result, financial institutions would likely rely on tighter credit standards and reduced availability of credit card services to a greater degree, as compared with retail credit card issuers.

## Chapter 5

## EVIDENCE OF THE EFFECTS ON CONSUMERS OF CREDIT CARD RATE RESTRICTIONS

Evaluating the impact on consumers of placing a national ceiling on allowable credit card interest rates is a complex undertaking, as previously noted. Experience indicates that credit card issuers and consumers are likely to react to a restrictive rate ceiling in a variety of ways. While some responses are relatively definite and fairly predictable, others are more problematic. A considerable body of evidence has been produced during the last two decades on creditor responses to the effects of interest rate restrictions at the state level. This evidence, which provides the best source of information about the likely effects of a nationally established credit card rate ceiling on particular groups of consumers, is reviewed below.

Effects on Credit Availability

One likely creditor response to the imposition of a restrictive credit card interest rate ceiling, as previously discussed, is a tightening of credit standards accompanied by a reduction in the availability of credit card services to consumers. The association between the introduction of restrictive rate ceilings for consumer credit and the imposition of tighter lending standards by creditors is well established in the economic literature.<sup>1/</sup> For example, several studies have found an inverse relationship between legally permitted finance rates and consumer loan rejection rates.<sup>2/</sup> Similarly, these

<sup>1/</sup> See appendix A for a partial list of studies.

<sup>2/</sup> Douglas F. Greer, "Rate Ceilings and Loan Turndowns," Journal of Finance 30 (December 1975), pp. 1376-83. Also, consumer survey data indicate that in a state with a low interest rate ceiling (Arkansas), a higher proportion of consumers reported being rejected for consumer credit as compared with consumers residing in states with less restrictive rate ceilings. See Richard Peterson

studies have established a positive association between higher rate ceilings and bad debt loss experience.<sup>1/</sup> This association indicates that creditors adjust risk acceptance in relation to the expected gross return on their consumer loan portfolios. Therefore, creditors apply more accommodative credit standards when the price of credit is determined by market forces; and they use stiffer loan criteria if regulations hold rates at below-market levels.

This evidence indicates that restrictive interest rate ceilings on consumer credit limit the ability of some consumers to obtain credit. However, not all consumers are affected equally by restrictions on credit availability. Consumers who barely satisfy the requirements to qualify for a credit card in an unrestricted market are the group most apt to be excluded if a below-market rate ceiling is imposed. Based on the elements that credit card issuers usually include in credit scoring and judgmental systems for determining credit worthiness, lower income families and families headed by younger persons are among those most likely to be adversely affected by restrictive credit card rate ceilings.<sup>2/</sup>

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and Gregory Falls, "Impact of a Ten Percent Usury Ceiling: Empirical Evidence," Working Paper No. 40 (1981), Credit Research Center, Krannert Graduate School of Management, Purdue University.

1/ For example, see Robert P. Shay, "Factors Affecting Price, Volume and Credit Risk in the Consumer Finance Industry," Journal of Finance 25 (May 1970), pp. 503-15. Also see Management Analysis Center, "A Study of Bank Credit Card Profitability for Banks Operating in the States of California and Washington," Palo Alto, California (June 1, 1977), p. 73.

2/ For a discussion of factors credit card issuers consider in their point scoring systems, see William C. Dunkelberg, "An Analysis of the Impact of Rate Regulation in the Consumer Credit Industry," in National Commission on Consumer Finance: Technical Studies, vol. 6, Washington, D.C.: U.S. Government Printing Office, [1973], pp. 17-20.

Effects on Bank Credit Card Availability

Specific evidence on the effects of credit card rate restrictions on consumers is available from several relatively recent studies. In 1979, the Credit Research Center (CRC) of Purdue University surveyed consumers and creditors in Arkansas, Illinois, Louisiana, and Wisconsin.<sup>1/</sup> The surveys were part of a study of credit regulation effects on consumer credit, including the impact of differing consumer credit interest rate ceilings on the availability and the use of consumer credit.<sup>2/</sup>

One portion of the 1979 CRC study focused on consumer use of credit cards in each of the four states. Analysis of these data provides some indication of the likely effects of a proposed national credit card rate ceiling on the availability of credit card credit. The four states were divided into two groups. States with relatively unrestricted credit card markets constituted the first group, which included Illinois, Louisiana, and Wisconsin. Although these three states did have rate ceilings on revolving credit, their respective rates (18 percent, 21.6 percent, and 18 percent) were considerably less restrictive than the 10 percent rate ceiling in Arkansas, which constituted the second group.

The Purdue study found bank credit card holding to be substantially less widespread in Arkansas than in the three states with less restrictive

<sup>1/</sup> William C. Dunkelberg, et al, CRC 1979 Consumer Financial Survey, Monograph No. 22 (1981), Credit Research Center, Krannert Graduate School of Management, Purdue University.

<sup>2/</sup> To reduce the likelihood that variations in consumer credit use in the four markets were due to factors other than differences in credit regulations, the markets selected for the survey were as similar as possible in socioeconomic and other characteristics.

interest rate ceilings. Only 29 percent of the families in Arkansas held bank credit cards in 1979 whereas 39 percent of families in the other three states held such cards (table 5.1).<sup>1/</sup> This finding is consistent with the view that restrictive rate ceilings curtailed bank credit card availability to some consumers.

Although it provides a useful starting point, this aggregate information does not indicate which groups of consumers are most likely to be affected by the imposition of a national credit card rate ceiling. To help address this issue, comparisons were drawn between patterns of bank credit card holding in Arkansas and in the other three states, broken down by family socioeconomic characteristics (table 5.1). In all four states, bank credit card holding rose at higher levels of family income. However, in most income categories, a significantly smaller proportion of families held bank credit cards in Arkansas than in the other three states that had less restrictive rate ceilings.

The Purdue study also found that differences in the proportions holding bank credit cards existed across age, education, racial, marital status, homeownership status, and length of time on the job categories for the two groups of states. Among families headed by persons less than 45 years of age in 1979, 34 percent, on average, held bank cards in Arkansas, whereas 42 percent held such cards in the other three states. Among homeowners, 33 percent held bank cards in Arkansas, whereas 47 percent held bank cards in the other three states. As expected, bank card holding rose steadily with the level of education attained by the family head. However, in all education categories,

<sup>1/</sup> The difference observed between the proportions of families holding bank credit cards in Arkansas versus the other three states is statistically significant at the 95 percent confidence level.



BANK CREDIT CARD HOLDING IN ARKANSAS  
COMPARED WITH SELECTED OTHER STATES<sup>1</sup>

Percent of selected group

| Family characteristic                        | Have bank credit cards |              |
|----------------------------------------------|------------------------|--------------|
|                                              | Arkansas               | Other states |
| All families                                 | 29                     | 39           |
| <u>Income<sup>2</sup> (dollars)</u>          |                        |              |
| Less than 6,000                              | 5                      | 10           |
| 6,000 - 8,999                                | 16                     | 17           |
| 9,000 - 12,499                               | 24                     | 22           |
| 12,500 - 17,499                              | 26                     | 36           |
| 17,500 - 19,999                              | 41                     | 48           |
| 20,000 - 24,999                              | 35                     | 52           |
| 25,000 - 29,999                              | 52                     | 57           |
| 30,000 and more                              | 61                     | 68           |
| <u>Age of family head</u>                    |                        |              |
| Less than 25                                 | 10                     | 19           |
| 25 - 34                                      | 30                     | 42           |
| 35 - 44                                      | 37                     | 53           |
| 45 - 54                                      | 40                     | 47           |
| 55 - 64                                      | 30                     | 42           |
| 65 - 74                                      | 21                     | 28           |
| Greater than 75                              | 17                     | 15           |
| <u>Education of family head</u>              |                        |              |
| 0 - 8 grades                                 | 9                      | 14           |
| 9 - 11 grades                                | 14                     | 26           |
| High school diploma                          | 25                     | 39           |
| Some college                                 | 36                     | 52           |
| College degree                               | 55                     | 72           |
| <u>Race</u>                                  |                        |              |
| White                                        | 31                     | 42           |
| Nonwhite                                     | 14                     | 27           |
| <u>Marital status</u>                        |                        |              |
| Married                                      | 35                     | 46           |
| Not married                                  | 19                     | 24           |
| <u>Home ownership status</u>                 |                        |              |
| Own home                                     | 33                     | 47           |
| Rent home                                    | 19                     | 17           |
| <u>Length of time on current job (years)</u> |                        |              |
| Less than 1 year                             | 24                     | 27           |
| 1 to 2 years                                 | 14                     | 35           |
| 2 to 3 years                                 | 37                     | 36           |
| 3 to 5 years                                 | 33                     | 44           |
| 6 or more years                              | 36                     | 54           |

1/ The four states in the study included: Arkansas, Wisconsin, Illinois and Louisiana. In total, 3,572 respondents participated in the survey; 787 from Arkansas, 1,006 from Wisconsin, 1,030 from Illinois and 749 from Louisiana. All surveys were conducted in person between January 6, 1979 and June 12, 1979.

2/ Income is for calendar year 1978.

SOURCE: CRC 1979 Consumer Financial Survey, Monograph No. 22 (1981), Credit Research Center, Krannert Graduate School of Management, Purdue University.

a smaller proportion of families in Arkansas held bank credit cards in 1979 than in the other three states.

While the data presented in table 5.1 are informative, they have one shortcoming. The close association between some family characteristics--for example, income and education--can obscure the true relationship between credit card holding and the rate restrictions in force when the Purdue study was conducted. This statistical problem can be overcome by using multivariate procedures that help establish the independent influence of each family characteristic on bank card holding.

The results of an analysis of this kind indicate that:<sup>1/</sup>

(1) in all four states, family income, age, and education of the family head were positively associated with the probability that a family held a bank credit card;<sup>2/</sup>

(2) lower- and lower-middle income families in Arkansas were less likely to hold bank cards than similarly situated families in the other states;

(3) in contrast to the pattern observed for lower- and lower-middle income families, higher income (\$25,000 or more) families in Arkansas were just as likely to hold bank credit cards as similarly situated families residing in states with less restrictive rate ceilings; and

(4) overall, families residing in Arkansas were significantly less likely to hold bank credit cards than families living in the three states with less restrictive rate ceilings.

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<sup>1/</sup> See appendix B.

<sup>2/</sup> This result is consistent with the findings of the 1983 Survey of Consumer Finances which included a nationally representative sample of families. See Glenn Canner and Anthony Cynrak, "Recent Developments in Credit Card Holding and Use Patterns Among U.S. Families," Journal of Retail Banking 7 (Fall 1985), pp. 63-74.

These findings indicate that lower- and lower-middle income families are more likely to be affected adversely by credit card rate ceilings than higher income families. This evidence is consistent with the conclusions reached in other studies.<sup>1/</sup>

In addition to the 1979 Purdue study, other research has examined the relationship between rate restrictions and the availability of bank credit cards to different groups of consumers. In their 1975 study of the credit card market in New York State, Shay and Dunkelberg examined the effects of credit card rate ceilings on bank card holdings. Their study employed the credit scoring model of a large bank credit card issuer and actual data about credit card account holders to examine the impact of changes in credit standards.

Table 5.2 shows the effect that successive 5-point increases in the minimum qualifying credit score would have on the ability of bank credit card account holders to qualify for the bank credit card they held. As previously discussed, increases in the minimum acceptable point scores needed to qualify for credit cards are one way that card issuers might respond to the imposition of more restrictive rate ceilings for credit cards.

Raising the minimum qualifying credit score from 19 points to 24 points would have prevented about 2 percent of the bank card holders from originally obtaining their credit cards. Eighty-nine percent of those who would have failed to qualify under this standard had incomes of less than \$7,500. It can be seen that credit rationing, as simulated in this example, would have

<sup>1/</sup> See, for example, Douglas F. Greer, "Rate Ceilings and Loan Turndowns," *Journal of Finance* 30 (December 1975), pp. 1376-83.

<sup>2/</sup> See Robert P. Shay and William C. Dunkelberg, "Retail Store Credit Card Use in New York," *Studies in Consumer Credit*, no. 4, New York: Graduate School of Business, Columbia University, 1975.

Table 5.2

REJECTIONS OF BANK CREDIT CARD HOLDERS DUE  
TO INCREASES IN THE MINIMUM ACCEPTABLE CREDIT SCORE<sup>1</sup>

| Change in the<br>minimum acceptable<br>credit score                                               | Proportion of bank<br>credit card account<br>holders that<br>would be rejected | Proportion of rejected<br>account holders with income<br>below specified level |                   |                   |                   |
|---------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|--------------------------------------------------------------------------------|-------------------|-------------------|-------------------|
|                                                                                                   |                                                                                | Up to<br>\$7,500                                                               | Up to<br>\$10,000 | Up to<br>\$15,000 | Up to<br>\$20,000 |
| Raise to 24                                                                                       | 1.6                                                                            | 89                                                                             | 89                | 100               | 100               |
| Raise to 29                                                                                       | 6.6                                                                            | 50                                                                             | 58                | 82                | 89                |
| Raise to 34                                                                                       | 18.4                                                                           | 30                                                                             | 55                | 77                | 91                |
| Raise to 39                                                                                       | 36.3                                                                           | 19                                                                             | 42                | 68                | 87                |
| Memo: Percent of total sample of<br>bank credit card holders with<br>income below specified level |                                                                                | 8.9                                                                            | 17.3              | 42.0              | 68.4              |

1/ Simulations based on a credit scoring model used by a large bank card issuer and on actual characteristics of credit card account holders.

SOURCE: Robert P. Shay and William C. Dunkelberg, "Retail Store Credit Card Use in New York," Studies in Consumer Credit, vol. 4, New York: Graduate School of Business, Columbia University, 1975, p. 55.

eliminated many of the lower income families without having much effect on the availability of credit card accounts to families at higher income levels. As shown in table 5.2, 100 percent of the account holders that would have been rejected were in the 42 percent of the total sample that had incomes below \$15,000.

If imposition of a rate ceiling caused the minimum qualifying bank score to be raised to 29 points, then about 7 percent of the card holders would have failed to qualify for their credit cards. Of this group, 58 percent would have had incomes below \$10,000, and 89 percent would have had incomes less than \$20,000. Thus, at this minimum credit score, some higher income account holders would have begun to feel the effects of credit rationing.

The simulation reported in table 5.2 suggests the credit rationing effect likely to result from progressively more restrictive rate ceilings.<sup>1/</sup> A government-imposed interest rate ceiling probably would curtail bank credit card availability, and likely would have a greater impact on lower income families--the same families that typically have less access to alternative sources of credit.

At the same time that credit card interest rate limitations limit access to credit by some consumers, they may encourage consumers who still can obtain credit cards to use their cards more intensively than they might if the price of credit were at a higher, unregulated level. According to the 1979 Purdue survey, consumers used every type of credit card more frequently in

<sup>1/</sup> A different simulation of the impact of a usury constraint on bank credit card ownership was performed by William C. Dunkelberg in "An Analysis of the Impact of Rate Regulation in the Consumer Credit Industry," in National Commission on Consumer Finance: Technical Studies, vol. 6, Washington, D.C.: U.S. Government Printing Office, [1973], pp. 20-23. This simulation used household data obtained from the 1967 Survey of Consumer Finances, Survey Research Center, University of Michigan. The results of this simulation are quite similar to the effects portrayed in table 5.2.

Arkansas than in the group of states with higher interest rate limits.<sup>1/</sup> In addition, the percentage of the available credit lines used by consumers in Arkansas was higher for each type of card than it was in the other states. Overall, card holders in Arkansas carried higher average balances on their credit cards than consumers in the other states and were less likely to pay off their revolving credit accounts each month.

#### Effects on Retail Store Credit Card Availability and Product Prices

If a federally mandated credit card rate ceiling is likely to result in bank credit card rationing, as suggested by the Shay and Dunkelberg study, what alternative sources of credit would remain available to rationed consumers? The 1979 Purdue study found that consumers in a constrained market shift from sources of cash credit, such as bank credit cards, to sources of sales credit, such as retail store credit cards.

The Purdue study provides information on patterns of retail store and bank credit card holding in states affected by much different rate ceiling restrictions. The proportion of all families holding retail store cards in Arkansas--60 percent--was about the same as the 58 percent share that held such cards in the states with less restrictive interest rate ceilings (table 5.3). The survey data also indicate that store cards are widely held by virtually all family groups in all four states.

The finding that approximately equal proportions of families held retail store credit cards in Arkansas as in the other three states stands in sharp contrast to the pattern of bank credit card holding noted earlier. As mentioned, a smaller fraction of families residing in Arkansas held bank credit

<sup>1/</sup> See CRC 1979 Consumer Financial Survey, Monograph No. 22 (1981), Credit Research Center, Krannert Graduate School of Management, Purdue University, pp. 57-74.



Table 5.3

**RETAIL CREDIT CARD HOLDING IN ARKANSAS  
COMPARED WITH SELECTED OTHER STATES**

Percent of selected group

| Family<br>characteristic                         | Have retail credit cards |              |
|--------------------------------------------------|--------------------------|--------------|
|                                                  | Arkansas                 | Other states |
| All families                                     | 60                       | 58           |
| <u>Income<sup>1</sup> (dollars)</u>              |                          |              |
| Less than 6,000                                  | 24                       | 29           |
| 6,000 - 8,999                                    | 48                       | 38           |
| 9,000 - 12,499                                   | 53                       | 43           |
| 12,500 - 17,499                                  | 69                       | 55           |
| 17,500 - 19,999                                  | 70                       | 64           |
| 20,000 - 24,999                                  | 83                       | 74           |
| 25,000 - 29,999                                  | 78                       | 80           |
| 30,000 and more                                  | 88                       | 83           |
| <u>Age of family head</u>                        |                          |              |
| Less than 25                                     | 38                       | 35           |
| 25 - 34                                          | 60                       | 63           |
| 35 - 44                                          | 70                       | 70           |
| 45 - 54                                          | 71                       | 69           |
| 55 - 64                                          | 67                       | 59           |
| 65 - 74                                          | 53                       | 48           |
| Greater than 75                                  | 40                       | 34           |
| <u>Education of family head</u>                  |                          |              |
| 0 - 8 grades                                     | 39                       | 34           |
| 9 - 11 grades                                    | 38                       | 47           |
| High school diploma                              | 65                       | 60           |
| Some college                                     | 68                       | 68           |
| College degree                                   | 80                       | 82           |
| <u>Race</u>                                      |                          |              |
| White                                            | 64                       | 61           |
| Nonwhite                                         | 42                       | 47           |
| <u>Marital status</u>                            |                          |              |
| Married                                          | 70                       | 67           |
| Not married                                      | 45                       | 40           |
| <u>Home ownership status</u>                     |                          |              |
| Own home                                         | 71                       | 66           |
| Rent home                                        | 36                       | 34           |
| <u>Length of time on<br/>current job (years)</u> |                          |              |
| Less than 1 year                                 | 49                       | 45           |
| 1 to 2 years                                     | 57                       | 54           |
| 2 to 3 years                                     | 61                       | 59           |
| 3 to 5 years                                     | 67                       | 63           |
| 6 or more years                                  | 76                       | 72           |

.1/ Income is for calendar year 1978.

**SOURCE:** CRC 1979 Consumer Financial Survey, Monograph No. 22 (1981),  
Credit Research Center, Krannert Graduate School of Management,  
Purdue University.

cards, as compared with families living in other states. These contrasting findings help confirm the expected effects of rate ceiling regulations. Unlike bank credit card issuers, retail store credit card issuers may partly offset the effects of restrictive interest rate ceilings by raising the prices of some products that they sell.<sup>1/</sup> In other words, retailers may be able to respond to a restrictive interest rate ceiling by maintaining the availability of credit card accounts and by compensating for any reduction in finance charge revenue by increasing the prices of certain goods.

Evidence that such price increases occur in states with restrictive rate ceilings is presented in a study by Gene Lynch, who compared product prices in Arkansas--a state that had a maximum interest rate of 10 percent on all types of credit--to prices in surrounding states where rate ceilings were higher.<sup>2/</sup> He found that major appliances cost about 3 to 8 percent more in Arkansas--nearly 5 percent more on average--than in the other states.

Further evidence that product prices might rise if a federally mandated credit card rate ceiling were adopted is contained in the 1979 Purdue study. One finding of that analysis was that bank credit card issuers in Arkansas charged retailers higher merchant discount fees than those charged by bank card issuers in the states with less restrictive rate ceilings.<sup>3/</sup>

<sup>1/</sup> The ability of retailers to adjust product prices in response to interest rate ceilings may be constrained by prevailing economic conditions and, as noted earlier, by competition.

<sup>2/</sup> The products most likely to be affected are those that usually are purchased with credit cards--large durable goods in particular. See Gene C. Lynch, "Consumer Credit at Ten Percent Simple: The Arkansas Case," Fayetteville, Arkansas: College of Business, University of Arkansas, 1969.

<sup>3/</sup> See Robert W. Johnson, "Retailers: CRC 1979 Creditor Survey," Monograph No. 19 (1980), Credit Research Center, Krannert Graduate School of Management, Purdue University, pp. 11-12. An association between a low bank credit card rate ceiling and a relatively high merchant discount rate was also found in

As with other costs, retailers will seek to offset these higher fees by charging higher product prices. One consequence is that consumers who do not use credit cards may subsidize the cost of providing credit card services. Since lower income families that have limited access to credit are heavily represented in the group that purchases products exclusively by using cash, a national credit card rate ceiling may fall more heavily on this group of consumers than on others.<sup>1/</sup>

In summary, research that reflects the experience of individual states suggests that the imposition of a federally mandated credit card interest rate ceiling might adversely affect many consumers. Previous studies have found that tighter ceilings on credit card interest rates resulted in reduced availability of bank credit card services to consumers--especially lower income families. These studies indicate that consumers who cannot obtain cash credit, such as bank credit cards, often substitute sales credit, such as retail credit cards. Providers of sales credit appear to offset reduced finance charge revenue at least in part by raising the prices of some products. Higher prices potentially affect all consumers. However, cash purchasers--that include a heavy concentration of poorer families--may be particularly disadvantaged because the higher product prices they pay result in a subsidy of credit card users.

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a study of California and Washington card issuers. The study found that the average merchant discount in California during the period January 1973 through December 1975 was 2.62 percent. In contrast, in Washington state, which imposed a relatively low 12 percent rate ceiling, the average merchant discount was 3.1 percent. See Management Analysis Center, "A Study of Bank Credit Card Profitability for Banks Operating in the States of California and Washington," Palo Alto, California (June 1, 1977), p. 19.

<sup>1/</sup> Of the families with incomes below \$5,000 in 1983, 84 percent had no outstanding consumer installment debt. In contrast, only 53 percent of the families with incomes above \$50,000 had no installment debt. See Robert B. Avery and others, "Survey of Consumer Finances: A Second Report," Federal Reserve Bulletin 70 (December 1984), table 4, p. 860.

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## APPENDIX B

## MULTIVARIATE ANALYSIS OF BANK CREDIT CARD HOLDING

To investigate and isolate the separate effects of various socioeconomic factors on bank credit card holding, a multivariate statistical model was formulated. Aside from various socioeconomic variables (income, age, education, race), the model incorporates a series of dummy variables that serve to isolate the separate effect of residence in Arkansas on the probability that families of varying income levels held a bank credit card.

The model estimates the probability that a family participating in the 1979 Purdue study held a bank credit card. This probability is assumed to be a function of several variables that specify the socioeconomic attributes of the consumers residing in the four states covered by the Purdue study. The model was estimated using a maximum likelihood logistic (logit) program.<sup>1/</sup> Variable definitions and logit regression results are presented in the following pages.

<sup>1/</sup> For a description of the logit technique, see G. S. Maddala, Limited-Dependent and Qualitative Variables in Econometrics, New York: Cambridge University Press, 1983.

B - 2

## VARIABLE DEFINITIONS

Independent Variable

|         |                                                                                                    |                                                                                                                                            |
|---------|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|
| INCOME1 | - Dummy variable,                                                                                  | 1 if family income between [\$ 0- 5,999],<br>0 otherwise                                                                                   |
| INCOME2 | - Dummy variable,                                                                                  | 1 if family income between [\$ 6,000- 8,999],<br>0 otherwise                                                                               |
| INCOME3 | - Dummy variable,                                                                                  | 1 if family income between [\$ 9,000-12,499],<br>0 otherwise                                                                               |
| INCOME4 | - Dummy variable,                                                                                  | 1 if family income between [\$12,500-17,499],<br>0 otherwise                                                                               |
| INCOME5 | - Dummy variable,                                                                                  | 1 if family income between [\$17,500-19,999],<br>0 otherwise                                                                               |
| INCOME6 | - Dummy variable,                                                                                  | 1 if family income between [\$20,000-24,999],<br>0 otherwise                                                                               |
| INCOME7 | - Dummy variable,                                                                                  | 1 if family income between [\$25,00-\$29,999],<br>0 otherwise                                                                              |
| AGE     | - Continuous variable,                                                                             | age of family head (years)                                                                                                                 |
| EDUCTN  | - Continuous variable,                                                                             | highest grade completed by family head (grade)                                                                                             |
| RACE    | - Dummy variable,                                                                                  | 1 if family head is white, 0 if family head<br>nonwhite                                                                                    |
| INCST1  | - Dummy variable to<br>assess the credit<br>rationing effect on<br>lower income families           | income between [\$0-17,499] times dummy vari-<br>able - 0 if consumer resides in Arkansas,<br>1 if consumer resides in another state       |
| INCST2  | - Dummy variable to<br>assess the credit<br>rationing effect on<br>lower-middle income<br>families | income between [\$17,500-24,999] times dummy<br>variable - 0 if consumer resides in<br>Arkansas, 1 if consumer resides in another<br>state |
| INCST3  | - Dummy variable,                                                                                  | income between [\$25,000-29,999] times dummy<br>variable - 0 if consumer resides in<br>Arkansas, 1 if consumer resides in another<br>state |

Dependent Variable

|       |                  |                                                                                       |
|-------|------------------|---------------------------------------------------------------------------------------|
| BCARD | - Dummy variable | 0 if consumer does not have a bank credit card,<br>1 if family has a bank credit card |
|-------|------------------|---------------------------------------------------------------------------------------|

B - 3

LOGIT REGRESSION RESULTS<sup>1</sup>

Probability that a family held a bank credit card

| <u>Variable</u> | <u>Coefficient</u> | <u>Standard error</u> | <u>T-statistic</u> |
|-----------------|--------------------|-----------------------|--------------------|
| INCOM1          | -.3784081          | .2983575E-01          | -12.68305**        |
| INCOM2          | -.3303745          | .3258486E-01          | -10.13890**        |
| INCOM3          | -.2953601          | .2848572E-01          | -10.36871**        |
| INCOM4          | -.1930169          | .2678451E-01          | -7.206288**        |
| INCOM5          | -.4679483E-01      | .3422368E-01          | -1.367322          |
| INCOM6          | -.2715952E-02      | .3356624E-01          | -.8091319E-01      |
| INCOM7          | -.1745266E-01      | .3169035E-01          | -.5507246          |
| AGE             | .3120008E-02       | .5168014E-03          | 6.037149**         |
| EDUCTN          | .3981672E-01       | .2899875E-02          | 13.73049**         |
| RACE            | -.3067787E-02      | .5252689E-02          | -.5840408          |
| INCST1          | -.7787150E-01      | .2540906E-01          | -3.064714**        |
| INCST2          | -.1901949          | .4106420E-01          | -4.631648**        |
| INCST3          | -.4826190E-01      | .5984898E-01          | -.8063947          |
| CONSTANT        | -.5136044E-01      | .5515395E-01          | -.9312196          |

\*\* Significant at the 99 percent confidence level.

1/ In interpreting the signs of the variable coefficients, a positive sign means that if the corresponding variable increases in value the probability that a consumer held a bank credit card increases. For example, for the variable AGE, the coefficient .3120008E-02 indicates that the older a consumer is, the more likely they were to hold a bank credit card. The sign and magnitude of the coefficients on the set of dummy variables for income, INCOM1-INCOM7, indicate that as income increases the probability that a consumer held a bank credit card increases. The T-statistic column indicates the level of confidence at which a finding is statistically significant.

SOURCE: Computations based on data collected by the CRC 1979 Consumer Financial Survey conducted by the Credit Research Center, Krannert Graduate School of Management, Purdue University.



**First Data Resources Inc. • Transaction Services**

10825 Farnam Drive Omaha, NE 68154-3238

MEMORANDUM

**Edward C. Nafus**

President

May 12, 1986

TO: Ed Nafus  
FROM: Gene Kathol  
RE: COMMENTS ON SENATOR GORTON'S BILL - S2421

1. He mentions Visa/MasterCard when discussing sharing of bad debt losses indicating that interchange fees are the only method of sharing such costs.
2. He wants a disclosure of costs to the consumer up front on the account solicitation (APR, annual fee and grace period, if any). I see no real impact with this proposal.
3. He refers to "unfair balance calculation methods". If the method is disclosed and is not wrong - how can it be unfair.
4. He speaks of exhaustive explanations of balance calculations. Those which are exhaustive are no doubt that way because legal counsel for the financial institution was trying to meet the spirit and the letter of a difficult law, Reg. Z.
5. This bill means to set the price of credit at the national level. The variations he mentions are among the ways that credit grantors vary their product and pricing.
6. He indicates that "previous balance" and "ending balance" methods are unfair. He also states that methods other than "average daily balance" are allowed if they are more favorable to the consumer. He should realize that half the time they are more favorable to the consumer. This, by definition, creates an ambiguous situation.
7. Why pick on Visa and MasterCard. Why not include Discover, Choice, Amex Gold and any other widely used consumer credit instrument including automatic advances from checking accounts.

8. Although I agree that there are relatively few financial institutions which do not charge "average daily balance" interest, those that do use other methods, regardless of their impact on consumers, would be forced to change methods. This could involve several statement changes for us and our customer. More importantly however, this bill is very dangerous because it gives the Federal Reserve Board the task of defining "criteria under which a balance calculation method may be deemed to be an average daily balance...". Practically speaking, no entity could grant credit until the Federal Reserve Board ruled on its proposed methods and disclosure. The backlog of work required by the Federal Reserve Board would last for years. Once accomplished, if credit card issuers were still in business the on-going procedure for beginning a new credit operation would be extended by six (6) months or more.

In my opinion, class action suits could be brought against any financial institution that charged interest that did not have the specific approval of the Federal Reserve Board for its particular method.

9. One last point, although his comments indicate he only wants to address Visa and MasterCard, his bill states, "For any open end credit plan involving a credit card under which credit may be extended by a part other than the provider of goods and services...". This bill then clearly includes all open end credit extended by any entity since most cards (even private department store cards) have access to outside services or goods. This includes overdraft protection, most private label cards, J.C. Penney, Sears, Discover, Choice, Visa, MasterCard and most others.

MEMORANDUM

May 13, 1986

TO: Ed Nafus  
 FROM: Dennis Ketter  
 RE: S-2421 FAIR CREDIT ACT OF 1986

This Senate Bill appears okay as written, but its intent could preview other future problems for our customers at FDR.

1. Bill says use average daily balance method or a method more in the cardholder's favor.

This could add some extra (small) nightly processing time, but it shouldn't be a big deal to us.

It could have a big effect on our customers, however. If interest calculation becomes regimented, banks may look for more blue sky to provide product differentiation - probably not though - they are pretty creative already.

As written, by the way, this affects Choice, Amex, Sears, Diners, etc. in addition to the stated Visa and MasterCard.

2. The thrust of the bill is to slow (stop) out of state banks doing large pre-approvals to generate a bigger base. We do have customers like that who possibly are being looked at as a "bad actor" by Senator Gorton. Their growth programs might suffer if the Senator can follow through on his intentions to impede national solicitations.

3. Senator Gorton's bill also relates to large "out of state" issuers blanketing an area and not being subject to laws of the cardholders state of residence.

It never occurred to me before, but if cardholder's state of residence became the determining factor for interest methods, we would have to do some tap dancing to accommodate and it could be an expensive, negative influence on our nightly processing time.

mm



A NEW FOCUS ON RETAIL CUSTOMER VALUES

an article written exclusively for:

The JOURNAL OF RETAIL BANKING

by: Robert O. Metzger, Ph.D.  
University of Southern California

and

Sukhen Dey, Ph.D.  
Indiana University - South East

**Teaser:**

Since deregulation began in 1980, pundits and consultants have been "bank bashing" because bankers have been too slow to develop the products and services consumers allegedly want and resist the obvious solution to their marketing problems, i.e. transisting to the merchandising of a broad array of financial services products. This new up-scale retail bank customer research project performed on the West Coast, however, flies right in the face of much of what has been recommended. Very affluent customers, it would seem, are not interested in complex new products or sophisticated new services. What they want, and appear less and less able to get, is personalized attention and recognition. They certainly do not perceive of their banker providing much else.

**About the Authors**

Robert O. Metzger is Professor of Management (Adjunct) at the Graduate School of Business Administration, University of Southern California, where he lectures in business policy and the management of financial institutions. He has been a consultant to the banking industry for more than a decade.

Sukhen Dey is Assistant Professor of Computer Sciences, Indiana University - South East where he lectures in computer sciences. He has been a consultant to the banking industry in the field of market and statistical research for a number of years.

June 1986

A New Focus on Retail Customer Values

by: Robert O. Metzger

and

Sukhen Dey

**Introduction**

Since deregulation began to envelope the banking industry in 1980, a number of pundits have berated bank management for its lack of marketing orientation, customer needs sensitivity and imagination; and, have compared the industry generally and specifically to GM management in the mid-70s, struggling to survive amid much more sophisticated, customer-oriented competition. These industry analysts and consultants have compared retail banking with merchandising and talk freely and passionately about boutique banks and bankers learning how to manage financial supermarkets. Slowly the groundswell built until 1983 when many in the industry were devoting much of their marketing budgets to new products and "High Tech" EFT systems development. Home banking and financial counseling became the new buzz words, and a bank really wasn't "de rigueur" unless the branch personnel had been subjected to a course in personal money management or telemarketing. Banks which had never had an MBA on the staff suddenly were developing full-fledged marketing departments. Yet, something else appears to have been happening simultaneously. Retail customers were becoming less enamored with their bankers. Service charges were being increased, branch staff was being cut to acknowledge the increased productivity provided by newly installed automation; or, loan officers were being pulled from branches into "hub" offices twenty miles away. A number of major banks, in an effort to cut personnel costs, have replaced customer service specialists answering telephones with automated recording devices to take messages. Further, many of the new products and services developed were so involved that customer service personnel couldn't explain them to the satisfaction of depositors. In the center of this financial services maelstrom, a major upscale customer marketing study was begun in late 1985 to better understand what the most affluent retail depositors really want from their banks. Those bankers who have just committed to home banking, insurance and discount brokerage had better take heed.

### Review of the Literature

Critical to these urgings by marketers and consultants alike to develop new products and services should be in-depth customer-based research. However, it would appear that few such studies have been made public and those that have been published appear to contradict the direction the industry is being advised to take.

A survey of 3800 randomly selected households in 1983 shows little support for the "financial supermarket" theory. The study (Avery, et al; 1985) goes on to point out that the rate of return to a bank can easily outweigh the advantages of contemporary convenience-related services irrespective of customer income levels. Several focus group studies coupled with large sample interviews demonstrated that the typical institution now offers over 30 products and anticipates offering travel and real estate services while consumers simply cannot process all these changes so they resort to old values - courteous, friendly service and convenient, modern facilities (Christy, 1985). This may, in part, also explain the continued resistance by retail customers beyond 65% in the use of ATM machines. This resistance is a part of a broad array of psychological and sociological concepts including habit, primacy, dependence, self-distrust, insecurity and perceived risk (Murdock, et al; 1983).

In fact, quite in the face of all this new product development, retail customers in general are satisfied with the levels of service they receive from their bank (Mandell, et al; 1981). And a recent ABA study shows that, although there may be some concern about the general image of banking institutions, consumer attitudes toward their primary bank are very positive (Madden, 1985).

The major factors used by retail customers to evaluate their bank are flexibility, convenience and rate of return (Krane, 1983). And, these factors appear to continue playing the most critical roles. A recent survey of 600 randomly selected households in five major SMSAs reports that this trend continues. The majority (70%+) use a bank as their primary institution, and their principal reasons for choosing the bank they did was its proximity to their home, efficient service and perceived safety. Less than 6% of those queried chose their primary financial institution because it "offered the services I wanted" (U.S. League, 1986).

Coincidentally, another new survey of over 800 East Coast retail depositors showed that a majority were generally satisfied with their bank, would prefer higher levels of personal service and actually resent much of the new product and services development to the extent that they perceive it takes away from the personal service levels they would like (Gwin and Lindgren, 1986). Such customer bias appears to be backed up by behavior, too. Since deregulation, the financial services industry has actually experienced disappointment with respect to the levels of acceptance of direct deposit, bill paying, POS and home banking services (Reich, 1985).

Yet, few banks seem to review the literature or base new product or services decisions off their own research. Wells Fargo may be the exception. Wells, while as internally automated as any other major retail bank, has held off home banking as it appears to be a big "turnoff" for customers of other banks (Benoit, 1984).

But, more typical of the industry is the lemming-like rush to discount brokerage services without specific research or strategy. Of 160 banks surveyed by the Wall Street Research Group in 1983, 81% indicated that they offered or were planning to offer discount brokerage services. While 43% indicated that they had a vague but generalized objective in doing so of "added" profit, fully 23% stated that they had no specific objectives in mind by introducing the service (Blount, 1983). In fact, other than articles based purely on personal opinion or "Op Ed" type articles which are profligate in many banking magazines, the authors could not find any reported research which indicated the majority of retail customer of any bank or S&L are desirous of more services and products at their primary financial institution. This kind of literature might best be summed up by an article headlined, "Banks Hiring Retailing Consultants for Help in Becoming Financial-Products 'Stores'". It cites the efforts of a major mid-West bank in its efforts to find new customers. A consultant is quoted as stating that his firm assists banks to merchandise their services to the level of the Nieman-Marcuses, the Bonwit Tellers and the Bergdorf Goodmans by having insurance agents, travel agencies, tax preparers and financial consultants in separate areas of large branches to give the impression of a true upscale retail financial merchandiser (Weiner, 1986). To read the article one would tend to believe this is what the leaders in the industry are doing - the wave of the future. But, at the close of the article, the reporter notes that so far the insurance agent and the realtor find few customers seeking them out. Unfortunately, it would appear that many bankers do not choose to distinguish between the propriety articles and those based on actual customer-based research.

### The West Coast Study

To help clarify this situation for a \$200MM West Coast community bank and to aid it in its efforts to develop those new products and services desired by its upscale customers, the authors developed a detailed product and services oriented questionnaire to test retail customer preferences and decision factors relative to their banking relationships. The basic questionnaire had been used and modified several times with various retail banks and thrift institutions. This latest version was developed for a California client which serves a particularly affluent marketplace in an already affluent area of California. 1982 per capita income in the County is estimated in excess of \$22,000 while the bank's retail customer income averaged in excess of \$60,000 in 1985. The questionnaire was mailed to every retail checking account customer with a balance in excess of \$1,000 (approximately 4,500 accounts) with the questionnaires segregated between those customers with balances in checking, NOW, money market checking or money market savings accounts between \$1,000 and \$9,999 and those with balances of \$10,000 or more. This \$1,000 cut off was a reflection of Pareto's Law at the bank, i.e. these customers represent that 20% of all accounts which, in turn, make up 80% of all retail checking deposits at the bank. It is this segment of depositors which every retail bank would like to expand and most community banks consider it their "prime customer" segment. Only one mailing was made with a personalized cover letter from the president of the bank asking customers for their assistance with respect to new services development.

—The questionnaire posed 27 complex questions, principal among them being a review of 23 general retail banking services. Customers were asked whether or not these services were used at their primary financial institution. A similar review of some 13 specialized services not currently offered by the bank was performed also, and customers were asked if they would use these services if their primary bank developed them. They included services such as investment counselling, insurance, discounts on merchandise and home banking. Another set of questions reviewed the importance of 24 factors vis-a-vis the customer's original decision to open their account. Also tested were customer evaluations of the interest rates paid on various products; an identification of how and where customers learn about new financial services; how many and what kinds of accounts customers keep with various financial services institutions; and, a review of how customers invest their

assets. While there were a number of detailed demographic questions raised, too, these are the ones which have the greatest bearing on current industry retail marketing and strategic activities; and, while the preferences of the most affluent depositors in a very affluent area cannot be transposed to reflect the preferences of all retail depositors across the nation, the authors intentionally posed the questions about the responder's **primary financial institution**, which, in the case of over 20% of these customers, was not the bank sponsoring the research. To the extent that non-primary customer responses were identical in most respects with those of primary customers, the results do infer more general depositor values.

#### Customer Demographics

Some information should be provided on the demographic findings of this group due to its unusual affluency, education levels and employment patterns. Certainly similar research would provide somewhat different results in the Los Angeles barrio or the Upper East Side of Manhattan. The response of almost 900 customers from the original 4,500 was particularly robust. 60% of those responding provided the bank with additional handwritten comments after filling in the very exhaustive questionnaire. The demographics of these retail depositors show that the largest single group, over 28%, are professional people. 66% are married, while over 80% own their own home. Over 65% of the respondents have a family income in excess of \$50,000 and more than 25% have annual incomes in excess of \$100,000. 92% stated that they have some college education, 69% are college graduates and 86.2% of the spouses have some college. 29% attended graduate schools. While 75% stated that they were between the ages of 35 and 64, fully 75% of the married respondents stated that they have no children living with them. Their children are either grown up and gone or away at school. In spite of these income levels, over 50% of the spouses stated that they work fulltime and more than one in four of them is a professional (doctor, lawyer, dentist) also.

#### Summary Findings

The authors found that most of these affluent retail bank customers perceive their primary bank to be principally a custodian of their liquid assets, close to home, whereby they can have convenient access to them. Beyond this, these depositors do not perceive of any other major relationship with their bank or its staff. It would appear that they already

have fixed relationships with pension and trust advisors, CPAs and tax attorneys, major brokerage houses and professional, full time investment advisors. After 50 years of being regulated out of these services, bankers are not thought of in this context nor do these retail customers perceive that their banker can do a credible job in these areas. To the contrary, **over 85% of these retail customers stated that they do not now use nor do they have any interest in any of the new products or services proposed for development in the survey by their primary financial institution.** The remaining 15% or less of the responses showed that, depending on the product or service proposed, some customers would be interested; however, in many publicized areas such as home banking, telephone bill paying, tax and travel related services, at an average, while only 7-8% of the customers indicated that they would utilize these services if they were offered, up to 30% stated that they absolutely would not seek such services from their primary financial institution even if they were developed. It is this vehemence of rejection, more than anything else, which communicates much of the customers' perceptions.

Finally, in summary, what is of prime importance to these customers is the level of attention and recognition they receive when they do visit their bank. In the hype of the industry today, "High Touch" won over "High Tech" by a margin of 11 to 1.

## Detailed Results

### 1. General Services Utilization

Customers were asked: did they currently use any of some 23 typical bank services? The results appear below.



| <u>Service Offered</u>            | <u>% Customers Use Service*</u> | <u>Heavy User Clusters</u> |
|-----------------------------------|---------------------------------|----------------------------|
| ATM Machines                      | 57.6%                           | Singles, Professionals     |
| Travellers Checks                 | 56.8%                           | >\$50K IncomeGroup         |
| Overdraft Protection              | 54.0%                           | >\$50K, Professionals      |
| Safe Deposit Boxes                | 45.2%                           | >\$50K, Homeowners         |
| Bank-By-Mail                      | 43.9%                           | >\$50K, Professionals      |
| Money Market Savings Accounts     | 41.0%                           | >\$50K, Homeowners         |
| Regular Savings Accounts          | 40.5%                           | Females                    |
| NOW Accounts                      | 39.7%                           | >\$75K, <\$25K, Homeowners |
| Credit Cards                      | 38.7%                           | >\$50K IncomeGroup         |
| Money Orders                      | 33.6%                           | >\$50K IncomeGroup         |
| Personal Line of Credit           | 28.8%                           | >\$50K IncomeGroup         |
| Automated Balance Information     | 28.7%                           | >\$50K, Females            |
| Money Market Checking Accounts    | 28.2%                           | >\$50K, Homeowners         |
| Certificates of Deposit           | 20.2%                           | >\$50K IncomeGroup         |
| Auto Loans                        | 17.6%                           | Males                      |
| Direct Deposit Services           | 16.3%                           | >\$50K, Professionals      |
| IRA Accounts                      | 15.5%                           | Married, Professionals     |
| Direct Deposit of Social Security | 15.1%                           | Over 60 Group              |
| Mortgage Loans                    | 7.2%                            | Married                    |
| Automated Bill Paying Services    | 6.9%                            | Married, Professionals     |
| Payroll Savings Plans             | 4.9%                            | \$25-50K Group             |
| Home Improvement Loans            | 3.3%                            | >\$50K, Married            |
| Telephone Bill Paying Services    | <1.0%                           | N.A.(too few)              |

\* These percentages reflect average responses across the multiple demographic cells tested.

## 2. Specialized Services Interest Levels

The respondents also were asked to state if they were interested in some 13 specialized services, many of them on the cutting edge of retail banking today. Specifically, customers were asked: if their bank developed these particular products, would they avail themselves of the service?

| <u>Service Offered</u>         | <u>Customers Interested</u> | <u>Customers Rejecting*</u> |
|--------------------------------|-----------------------------|-----------------------------|
| Escrow Services                | 11.8%                       | 10.6%                       |
| Estate Planning                | 12.3%                       | 15.0%                       |
| Trust Services                 | 9.0%                        | 11.0%                       |
| Home Banking                   | 9.0%                        | 5.7%                        |
| Company Retirement Plans       | 3.1%                        | <1.0%                       |
| Tax Preparation Services       | 1.0%                        | 26.0%                       |
| Tax Planning Services          | 10.0%                       | 13.0%                       |
| Catalogue Merchandise Services | <1.0%                       | 17.0%                       |
| Discount Brokerage             | 13.2%                       | 14.3%                       |
| Stock Portfolio Management     | <1.0%                       | 18.2%                       |
| Investment Advisory Services   | 2.4%                        | 14.3%                       |
| Will Preparation Services      | 15.0%                       | 15.0%                       |
| Insurance Brokerage            | 8.5%                        | 19.1%                       |

### 3. Magnet Factors

Customers, then, were asked to state which factors were most important to them in the selection of their primary bank. The following is a list in descending order of importance and the 10 most important factors appear to coincide closely with the results of a recent Bank Marketing Association survey.

| <u>Factor</u>                | <u>% Customer Feel Important*</u> |
|------------------------------|-----------------------------------|
| Accuracy                     | 96.8%                             |
| Quality of Overall Service   | 95.9%                             |
| Friendliness of the Staff    | 91.6%                             |
| Speed of the Teller Lines    | 90.1%                             |
| Insurance on Accounts        | 89.5%                             |
| Reputation of the Bank       | 88.4%                             |
| Branch Close to Home         | 86.0%                             |
| Expertise of Contact Officer | 84.3%                             |
| Innovative Services          | 73.5%                             |
| Rates Paid on Deposits       | 73.3%                             |

\*\*\*\*\*

|                                 |       |
|---------------------------------|-------|
| Bank Referred by Family Member  | 64.4% |
| Extended Hours                  | 63.8% |
| Branch Close to Work            | 63.3% |
| ATM Machines                    | 57.8% |
| Good Drive-Up Facilities        | 53.5% |
| Rates on Personal Lines         | 51.9% |
| Attractiveness of Bank Building | 50.0% |
| Rates Paid on IRA Accounts      | 49.9% |
| Rates on Installment Loans      | 48.5% |
| Scope of the Branch Network     | 36.4% |
| Rates on Mortgage Loans         | 32.7% |
| Branch Close to Shopping        | 23.2% |
| Statewide Offices               | 20.7% |
| Referral by Bank Employee       | 20.5% |

### 4. Number of Banks Used and Frequency

A further series of questions asked customers how many banks they used, and, with respect to their primary bank, how often they visited.

| <u>Number of Banks Used</u> | <u>% of Customers</u> |
|-----------------------------|-----------------------|
| Only One                    | 15.3%                 |
| Two                         | 35.3%                 |
| Three                       | 28.9%                 |
| Four or More                | 20.5%                 |

| <u>Frequency of Visits</u> | <u>% of Customers</u> |
|----------------------------|-----------------------|
| Daily                      | 2.1%                  |
| Twice Per Week             | 31.6%                 |
| Once Per Week              | 30.1%                 |
| 2-4 Times Per Month        | 25.3%                 |
| Once Per Month or Less     | 10.9%                 |

| <u>Travel Time to Primary Office</u> | <u>% of Customers</u> |
|--------------------------------------|-----------------------|
| <5 Minutes                           | 46.6%                 |
| >5 but <10 Minutes                   | 31.2%                 |
| 10-15 Minutes                        | 11.6%                 |
| >15 Minutes                          | 10.6%                 |

### 5. Personal Investments

Another key question was: In which ways do you invest your money? The responses were as follows:

#### a) Real Estate

Almost 600 of the 900 (60%) respondents cited Real Estate with 405 (46%) stating it was their primary investment. It is not clear how many included their home in the definition of Real Estate as an investment but the assumption is that most people did.

#### b) Savings Accounts

Second only to Real Estate, Savings Accounts were listed 287 times (32.5%) as a primary investment, 175 times as a secondary investment and 154 times as the third investment.

#### c) Common Stocks

Far behind Real Estate and Savings Accounts, Common Stock was cited as the primary investment in only 187 cases, 148 times as the secondary investment and 141 times as the third most important investment.

#### d) Mutual Funds

Almost tied with Common Stocks were Mutual Funds with very similar responses.

#### e) Certificates of Deposit

Closely behind Mutual Funds were CDs with 157 cases of primary citation.

#### f) Other Investments

Bonds, Insurance and Collectables were well behind all of the other investment vehicles.

A final question in this area was: Which institution performs these investment services for you? The responses were:

| <u>Institution</u>           | <u>% Customer Using</u> |
|------------------------------|-------------------------|
| Stock Broker                 | 45.5%                   |
| Savings & Loan               | 42.3%                   |
| Primary Bank                 | 36.6%                   |
| Other Institution            | 29.2%                   |
| Bank other than Primary Bank | 20.1%                   |
| Credit Union                 | 13.8%                   |

A key observation here is that while 45% of the respondents stated that they use a broker to handle their investments, stocks rated only third on the list of preferred investments and fewer than 5% of all respondents listed their broker as their primary financial institution.

#### 6. Financial Information Sources

The respondents were asked to list their principal source for information on banking services. The responses were as follows:

| <u>Information Source</u> | <u>% of Customers</u> |
|---------------------------|-----------------------|
| Bank Statement Stuffers   | 43.3%                 |
| Newspaper Ads             | 15.9%                 |
| Friends                   | 13.7%                 |
| Special Mail Fliers       | 12.3%                 |
| Lobby Displays            | 10.1%                 |
| Television                | 2.5%                  |
| Magazines                 | 1.7%                  |
| Radio                     | 0.4%                  |
| Billboards                | 0.1%                  |

#### 7. Customer Satisfaction Matrix

Finally, relative to the results to be reported in this article, customers were asked a series of questions pertaining to their perceived levels of satisfaction at their primary financial institution. The results of these questions have been combined into a matrix which reflects the satisfaction customers have with their primary bank relative to the perceptions they have as to the adequacy of the products and services currently provided. This matrix appears below and shows the income groups predominant in each quadrant.

|                |      |                              |                                   |
|----------------|------|------------------------------|-----------------------------------|
| Service Levels | High | 1<br>58.5%<br>incomes <\$50K | 2<br>20.9%<br>(even distribution) |
|                | Low  | 3<br>16.5%<br>incomes >\$50K | 4<br>4.1%<br>incomes >\$75K       |
|                |      | High                         | Low                               |
|                |      | Product Breadth              |                                   |

What this matrix infers is that 6 out of 10 of these retail customers (Qd 1) perceive that their primary bank currently provides them with a sufficient array of products and services together with a high level of personal service. Further, proportionately more of the customers with annual income of less than \$50K seem to share this feeling. Only a negligible number (4%) of all customers (Qd 4) feel that their bank fails to offer both a sufficient breadth of products and levels of personal service and attention. We also find higher incidences of this dissatisfaction among the most affluent customers who are more demanding in any event. In sum, 75% of all these retail customers perceive that their primary bank offers a broad enough range of products and services to meet their needs, while up to 80% of them feel that they are receiving satisfactory levels of personal attention from the bank. Thus, if this bank can be used in an exemplary manner, only 2 out of every 10 retail customers appear to be in need of something more in products and services, and these are most likely to be the most affluent customers.

#### Implications

The implications of these findings are manifold. It will take months to appreciate fully the conclusions to be drawn from the complete findings let alone the partial results reported here. However, the principal implications are clear. First, very affluent retail bank customers have a variety of relationships with various institutions. They do not feel it is important for any one bank to provide them with what industry executives have been led to believe is a "broad range of products and services", nor does the FDIC's \$100,000 limit on any one account seem to encourage "one-stop" banking for owners of large CDs. **These retail customers are basically satisfied with accurate, safe custodial services close to home.** They want easy access to their cash through ATMs, extended hours and drive-ups.

It is the opinion of the authors that as a result of 50 years of government regulation, retail customers have been forced to build professional relationships with other individuals and entities such as CPAs and investment advisors. After so many generations of these kinds of relationships, it is now inconceivable to sophisticated people that a bank could suddenly gain equal expertise in these fields. For example, the thought of giving up their relationship with a CPA or Investment Advisor to allow a banker to take on those roles is beyond comprehension to these customers. All they really want from their bank is that their "custodian" provides safe keeping and book keeping services quickly, accurately and with some recognition for the customer's loyalty. Also, as presented in an earlier table, at an average, only 10% of all retail customers seemed interested in the "non-custodial" products and services.

A second major implication is that interest rates and product variety are not as important as the level of personalized service. In reviewing four major interest bearing accounts, the respondents had no idea what interest rate they were being paid in over 65% of the cases, while an additional 15-20% of the respondents stated that they were being paid a competitive rate when, in fact, local S&Ls were paying more. This follows closely the findings of the matrix whereby customers receiving a lot of "High Touch" service perceived that the bank had a broad range of products and services when, in relationship to other very large banks, it does not. Throughout the survey, customers asked only for more drive-ups, longer branch hours, more ATMs, and service with a smile. As observed in previous studies conducted by the authors involving other banks, it appears that more and more retail customers are establishing financial relationships with in-house workplace facilities such as credit unions for their convenience and easy accessibility. In turn, especially large credit unions are responding to their patrons' needs by offering more banking products such as NOW accounts, personal lines of credit, short and long term investment instruments, travel services and prestige credit cards.

A principal finding of the Virginia study (Gwin and Lundgrin, 1986), one which was strongly supported in the West Coast research, is that customers are really not interested in their bank developing a broad array of new, technologically sophisticated products. The reaction to Home Banking on the questionnaire was minimal while the thought of bankers entering the Tax Preparation or Investment Advisory fields met with outright skepticism. If these results are any reflection of national trends, it would appear that about one third of the products and services currently offered by typical community banks are not used in sufficient volume to justify their continued survival. The majority of these respondents

feel that the breadth of products and services currently offered is already wide and sufficient for the level of relationship they intend to have with their bank.

A further implication from these findings is that even among the most affluent, more and more marriages see both partners working, not only to increase life styles, but also to take advantage of and utilize newly affordable education levels. As a result, the concept of a "housewife" managing the accounts of the family and being someone "free" to come into the bank anytime between 10 am and 3 pm is worse than erroneous; it is down right **archaic!** Explicit in this implication is that retail bankers must find a way to open the bank during those hours most convenient to their retail customers not just their merchant accounts. In other, recent non-related research, almost half of all surveyed consumers stated that their bank's hours were inconvenient (WSJ, 1986). If retail bankers cannot resolve this issue, they will have even less interface with their key depositors and less and less opportunity to provide them with the "High Touch", personalized service levels that they really want. Further, as retail customer traffic in the branches dries up even more, the incremental costs of keeping any branch office open will increase exponentially. This general phenomenon is demonstrated by the fact that more than 44% of the customers surveyed use Bank-by-Mail even though over 65% of them live within 5 minutes of a branch office. Drive-up facilities, if they are open after hours, and ATMs on the weekends are the second most convenient means of bank interface. This, in turn, implies that retail bankers will never get to practice much of their newly developed sales skills on their busiest, most affluent customers as they seldom come into the bank. The research also implies that while these prime customers are exposed to a lot of promotions by various financial institutions on television and radio and in their morning newspaper, they either "tune out" or do not give such promotions sufficient credence to warrant detailed attention. Depositors focus strongly, however, on their monthly statement stuffers.

A fourth major implication from the findings is that while affluent retail depositors may dabble in stocks and bonds, whether they earn \$25,000 or \$100,000 a year, most perceive of their home and other real estate as their primary financial investment; their liquidity accounts at their primary bank and in their S&L their second most important asset; and, their stocks are merely third. Therefore, it is even more important that the fundamental custodial services for these deposits are delivered faultlessly and with some appreciation. For example, while a customer's \$10,000 CD may not be very important to



the bank in its overall scheme of things, it is probably the major liquid investment of the family doing business with the bank. It is their savings which they have consigned to the bank for safe keeping. They want to place that deposit with a bank which sends off more signals which communicate the bank's pleasure at having the business.

### Strategic Lessons

It must be remembered that these findings reflect only the attitudes and values of a uniquely affluent group of customers belonging to one specific bank and cannot be indiscriminantly used to describe all or most customers of other retail banks. However, the findings of the Virginia research which was conducted at the same time among middle income depositors coupled with the January 1986 U.S. League survey support strongly the general findings of this research. As a result, the authors believe several strategic issues must be raised as a result of the findings. These strategic lessons are significant, too.

Foremost might be the finding that product development, especially in the "High Tech" area, appears far less important, necessary or desired than the further enhancement of personalized service levels in the branches. This "message" from the research flies in the face of a broad array of strategic steps taken over the past few years by retail banks, many of which have consciously decreased the "High Touch" aspects of retail banking in lieu of "High Tech". Clearly a reassessment is needed based on fundamental customer-preference and psychographics-based research. Schmenner (1986) displays a Service Process Matrix which demonstrated more and more banks moving diagonally toward the upper left from the lower right, "High Touch" toward "High Tech". These results infer that customers would prefer to see the movement down the diagonal, not up it.

A corollary to this finding is that such a high degree of adults are working in the mid-1980s that the traditional branch hours of 10 am to 3 pm serve only a minority of customers. Some new and highly creative solutions must be found if the relationship between retail banks and their best customers is not to be relegated to something akin to one's relationship with the telephone company (Metzger and Rau, 1983). Whether this issue is best addressed by finding new ways to service customers in their homes or by finding

cost-effective ways to operate branch offices especially in bedroom communities during totally different hours, is yet to be determined.

A further strategic lesson would be that while the very largest retail banks may continue to perform "High Tech" product research and development, for most banks, even large regional banks, they will not have segments of interested customers large enough to justify adopting many of these latest concepts including Home Banking. It, along with Telephone Bill Paying, does not appear to be of interest to these upscale depositors. Further, age appears to have little to do with the issue. For example, while our survey showed twice the level of acceptance for these services among those under 35 years of age as those over 35 should they be offered, the rates are so low, 18% versus 9% in Home Banking and 16% versus 8% in Telephone Bill Paying, that they are insignificant raw numbers to the bank. Certainly, they represent far too few customer for the institution to expend the funds to develop the services. With barely 15% of all respondents under 35, the youth market has little influence. It must be pointed out, too, that given the extraordinary levels of affluence among this survey base, it is not surprising to find so few customers under 35.

Far more important, we feel, are the overall levels of acceptance by both age categories to the bank's overall service levels. Returning to the four-box matrix displayed above, while 78% of the over 35's stated their overall satisfaction, 80% of the under 35's felt they were adequately served; and, even though this bank did not offer much in the way of EFTS or Home Banking in particular, while 74% of the over 35's stated they were satisfied with the products offered, 77% of the under 35 crowd agreed with that position. The only interpretation from these statistics, we believe, is that older customers are slightly more critical.

Finally, in the area of strategic lessons, one cannot escape the entire issue of credibility beyond a safe keeping relationship. While bankers have been quick to adopt a broad range of new services in a very short time, the marketplace appears nowhere near as quick to accept that bankers know what they are doing in those areas. Retail bankers must realize that they cannot change their basic image with customers from that of custodian to that of creative investment advisor in just a few short months or even years. It is a very large image gulf to span and may take several decades and a generation or more of new customers.

### Marketing Lessons

The marketing lessons to be derived from this research are equally important; and, while the development of any specific marketing plans or strategies in response to these findings goes far beyond the scope of this article, some discussion of the issues is warranted.

It is the authors' opinion that no retail financial institution should commit significant funds to new products or services without in-depth customer research. It is our own objective to follow-up these results with more detailed Focus Group sessions among selected customer segments at the bank.

Further, given that these prime retail customers find less and less time to visit their branch and seem to pay little heed to media-delivered financial services messages, marketers must rethink how they best can contact and communicate with their best retail customers. And, unless branch hours are to change drastically from the traditional 10 am to 3 pm, then the level of commitment to in-branch cross selling and more expensive, sophisticated CSRs should be reevaluated. Certainly it appears that such efforts, whatever their results, are not impacting the bank's most valuable depositors nor does it appear logical that such efforts would attract more such upscale customers who are too busy to come in to open a new account.

To the contrary, some innovation would appear appropriate by having branches in "bedroom" communities open from, say, noon until six or eight in the evenings. Many bankers talk about how expensive such efforts are, yet these same bankers would appear to ignore the expense of additional EFTS development unwanted by most customers. A community or upscale retail bank "investing" in branch hours convenient to the bank's best depositors might turn out to be a stellar investment! A number of banks and thrifts in New England are now operating their branches with up to 65% part time staff, staff that is intelligent, dedicated and loyal but which cannot work a full eight hour shift for a variety of reasons. Again, while this is better covered in a separate, additional article, several institutions have found that if they use the 25-40 year old mothers from 11 to 3 and the young singles after 3 pm, there is a great deal of employee satisfaction and a successful use of the technique known as "job pairing". If an institution uses this kind of teller, clerical and CSR labor, with no fringe benefits, such a branch might actually be less expensive than a current branch staff with full time employees, open during traditional hours.

Additional research would appear appropriate, too, in the area of regionality of customer biases. Issues such as degrees of EFTS acceptance, success of limited POS facilities, ATM usage levels, demand for drive-ups, etc. all seem to vary, often widely, between regions but little appears in the literature comparing such differences.

Also from a marketing standpoint, the entire premise fostered on the banking industry over the past five years that attempts to turn retail banks into merchandisers needs to be reformulated (Goldberg et al., 1982). It is apparent from the research that upscale retail customers do not perceive their bankers as able to successfully manage any form of giant financial supermarket. Those bankers are only digging their holes deeper in any event as teller and CSR turnover continues at 1980-82 levels in many banks, and training costs attributable to more sophisticated products continue to rise. What customers appear to want is something much more fundamental and akin to the basic relationship they had prior to deregulation with, perhaps, the one caveat that they get a market rate on their deposits. The jury is still out on the Sears et al. "financial services networks" built on the one-stop concept. Certainly Sears is not appealing as a merchandiser to the market segment addressed by the authors' research, so it is unlikely that it will appeal to it as a financial counselor. On the other hand, less discriminating, less experienced market segments may well focus on a Sears-type approach to the extent that if Sears satisfies their merchandise needs, as they accumulate some level of savings, these less affluent depositors will decide to bank and invest there. The probability of such a success increases, too, when the ability to borrow easily either directly or through the Discover card, is added to the campaign. Then again, Sears never has announced that it was going after the customers of U.S. Trust or Morgan Guarantee. The real battle here is with those banks outside major metropolitan areas, where, in light of this research, active, affluent customers are demanding ever greater personalized service levels in preference to anything else.

Perhaps the most important lesson, again, is that no bank should attempt to develop or introduce new retail products or services without performing customer-based research to determine which customers, if any, will use a service and if that segment is sufficiently large enough to provide for a return on the investment in the new service's development, marketing and maintenance costs.

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Sears, Roebuck and Co.  
 Corporate Governmental Affairs  
 Sears House  
 633 Pennsylvania Avenue, N.W.  
 Suite 600  
 Washington, D.C. 20004

RANDOLF H. AIRES  
 VICE PRESIDENT

202 / 737-4900

June 5, 1986

The Honorable Slade Gorton, Chairman  
 Subcommittee on Financial Institutions  
 & Consumer Affairs  
 Committee on Banking, Housing & Urban Affairs  
 United States Senate  
 Washington, D.C. 20510

Dear Mr. Chairman:

Sears is submitting the following comments on proposed credit card disclosure legislation to the Senate Banking Subcommittee on Financial Institutions and Consumer Affairs for inclusion in the hearing record.

Sears, Roebuck and Co. has a 75 year history as a provider of consumer credit through installment credit, SearsCharge and more recently through the Discover Card. Sears is committed to providing its credit customers with good value and convenience as well as helpful information regarding the proper use of credit.

As a natural extension of this commitment to the consumer, Sears supports legislative efforts which have the effect of ensuring that consumers are provided with useful information with which to shop for credit.

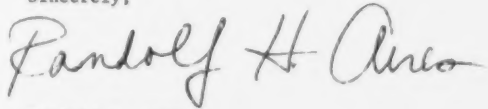
Meaningful disclosures in mailed solicitations for credit will enable consumers to identify a credit card that offers the greatest value for their individual credit needs. Since value, as it relates to the extension of credit, means something different to each credit customer depending on his or her individual credit card usage, proposals to disclose the essential cost components of a credit card are far preferable to proposals which would impose restrictions on a creditor's ability to price credit services. Examples of such restrictions are federal interest rate caps and mandated balance calculation methods.

The Honorable Slade Gorton, Chairman  
June 5, 1986  
Page Two

Attached to this letter are several recommended modifications to S. 2421 which carry out this general approach to the issue of disclosure, also for inclusion in the hearing record. Sears urges the Subcommittee to consider and adopt these modifications.

Sears looks forward to working with the Subcommittee to fashion legislation which will provide meaningful disclosures to consumers.

Sincerely,

A handwritten signature in cursive script, reading "Randolph H. Aires".

Randolf H. Aires  
Vice President  
Corporate Governmental Affairs

PHA/ss



RECOMMENDED MODIFICATIONS TO S. 2421

I. NOMINAL ANNUAL PERCENTAGE RATE, ANNUAL FEES, AND THE ABSENCE OF A GRACE PERIOD SHOULD BE THE FOCUS OF MEANINGFUL DISCLOSURE LEGISLATION:

The purpose of any disclosure legislation should be to provide consumers with meaningful cost information with which to shop for credit. This purpose can be accomplished by providing consumers with essential cost information in mailed solicitations.

The nominal APR, annual fee, and the absence of a grace period are the most significant cost components of credit transactions. The initial disclosure of these items would provide consumers with meaningful information with which to make a simple cost assessment, thereby assisting consumers in choosing the best credit card to fit their credit needs.

Sears recommends deleting the disclosure requirement for "other charges" associated with the issuance or use of the credit card. "Other charges" can be construed broadly to include fees such as late fees or returned check charges. Consumers generally do not choose a credit card based on these penalty fees. Current requirements of the Truth in Lending Act provide disclosure of these terms before the first transaction is made on the credit card. Sears believes this is the most appropriate time to make such disclosures.

Disclosures of the nominal APR, annual fee, and absence of a grace period will ensure simplified and meaningful disclosure for consumers.

II. MAILED SOLICITATIONS ARE THE PROPER DISCLOSURE VEHICLE:

Sears recommends deleting the disclosure requirement in section 2(c) of S. 2421 for advertisements mailed to the consumer.

There are several practical problems associated with making advance disclosures in advertisements, particularly for a national retailer such as Sears. First, SearsCharge must comply with 50 different state laws governing credit rates and terms. Full disclosure of the varied state rates and terms in an advertisement printed in a national magazine would be complicated and extensive and as a result, may actually create additional confusion for consumers.

Secondly, terms disclosed in an advertisement may change and material may become dated. Outdated information would confuse rather than enhance consumers' understanding of credit costs.

Finally, the term "advertisement" is broadly defined under the Truth in Lending Act. This broad definition, if applied to S. 2421, may be construed to require full disclosure in advertisements for merchandise which simply state that the consumer may purchase goods using a credit card. This clearly goes beyond the proper purpose of disclosure legislation which is to provide meaningful cost information in solicitations for new accounts.

For these reasons, Sears believes that requiring initial disclosure in advertisements is excessive and could confuse consumers rather than enhance their understanding of credit costs. Therefore, the reference to advertisements should be deleted and the focus should be primarily on mailed solicitations for credit.

### III. LEGISLATION SHOULD AMEND SECTION 143 OF THE TRUTH IN LENDING ACT:

Section 143 of the Truth in Lending Act currently provides guidelines regarding proper disclosure in advertisements which promote open-end credit plans. Since mailed solicitations are similarly designed to promote the extension of consumer credit, any legislation to require initial disclosure of credit terms in promotional materials should appropriately amend section 143.

Should Congress decide it is necessary to create an entirely new section of the Truth in Lending Act dealing with disclosure, it is essential that at the same time inconsistencies between that new section and the existing advertising section be resolved. These resolutions are necessary in order to help credit grantors know with certainty what disclosures are necessary and assures that the disclosures and advertisement requirements do not create an even more confusing situation for consumers.

### IV. DISCLOSURE LEGISLATION SHOULD PROVIDE FOR SOME FLEXIBILITY AMONG CREDITORS:

Disclosure legislation should provide creditors with the necessary flexibility to either disclose to the consumer only the rates and terms that apply to that particular consumer at the time of solicitation or, to disclose the rates and terms offered by the creditor to all consumers in the various states in which the creditor solicits new accounts.

In addition, any disclosure legislation should provide a creditor with the option of satisfying the disclosure requirement by including a copy of the entire credit agreement which meets the full disclosure requirements of the Truth in Lending Act.

### V. DELETE MANDATED AVERAGE DAILY BALANCE CALCULATION METHOD:

Sears is firmly opposed to any federally mandated restrictions on a creditor's ability to price credit services -- such as federal interest rate caps or mandated balance calculation methods.